COMMERCIAL BANKING

A Treatise Covering the Practical Operation of a Commercial Bank, the Theory of Money and Banking, and the Development of Banking in the United States

BY

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VOLUME II

FIRST EDITION

McGRAW-HILL BOOK COMPANY, INC.
NEW YORK 370 SEVENTH AVENUE
LONDON 6 & 8 BOUVERIE ST., E. C 4
1923

PRINTED IN THE UNITED STATES OF AMERICA

THE MAPLE PRESS - YORK PA

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CHAPTER XV

COLLECTIONS AND THE MESSENGER

The Messenger.—The messenger (sometimes called "runner") is the lowest in the scale of bank employment. The messenger is a beginner. His first duties consist in running errands in the bank, and carrying papers and mail to different departments and officials. In doing so he comes into contact with the executives of the bank and can so impress these officials with his personality and his characteristics that his advancement may be rapid. Whatever qualities, good or bad, he may have will quickly manifest themselves, and his career will be shaped accordingly.

When not employed in the messenger work about the bank, he may be engaged in presenting notes, bills of exchange, acceptances, etc., to the bank's customers; although this outside work requires boys of older age than the messenger work about the bank.

A large volume of bank business is transacted through the medium of the outside messenger force. Their activities consist in making collections, carrying money, securities and valuable documents from the bank to other banks and to the various customers and others. The force must necessarily be well organized and well directed. The messengers must know what to do under various circumstances, and the position, although regarded as the humblest in the bank, is nevertheless an important one.

Until the day's work is in shape to take out, the work of the messengers is comparatively light and these

employees are used wherever they are needed. Between ten and three they are out on their routes and at other times engaged in miscellaneous errands about the bank. They act as general assistants to various officers and departments, being in the nature of a flying squadron which goes where it is needed.

The messenger represents his bank and the bank is often judged and appraised by the conduct of the messenger. He can surely make friends and perhaps customers for his bank by the manner in which he conducts the relatively unimportant and yet important tasks which are given him.

In some banks the messengers are mature men, retired policemen and others who have concluded to spend their declining days in doing humble work rather than remain idle; or those who have been unfortunate in other lines of business and have taken up messenger duties for want of better things.

Qualifications for a Banking Career.—Inasmuch as the messenger is presumed to be entering upon a banking career, it is here appropriate to discuss the qualifications which he must have or acquire if he is to achieve even a moderate degree of success in banking.

In laying down the rules which make for business success, no two men will give the same essentials in detail, yet all will agree upon certain fundamentals, and certain characteristics. The recipes for success will therefore be as varied as those who compose them; but, like the recipes for cake will all contain the same fundamental ingredients. The man who assumes to discuss such rules will draw upon his own experiences and his own observations and make his prescription accordingly. The author must therefore be pardoned if he draws upon his own career for the rules which he considers essential to banking success.

Honesty.—As a general proposition the recipe for banking success begins with the admonition to be honest; but this is a necessary qualification for success in all callings and in every phase of life, and should be taken for granted. Honesty is not only the *best* policy, it is the *only* policy. No matter what may be the line of business the young man chooses, he will find opportunities to be dishonest. In selling goods there may be short weight or measure, false representation as to quality, misstatement of fact, little tricks that are unethical, and which are peculiar to the line of business. It should be the basic rule of all who aspire to business achievement to be "four square with the world," as Theodore Roosevelt put it; or in the words of the great commentator Blackstone, live honestly, harm nobody, and render every man his due.

Banking offers unusual opportunities to be dishonest, inasmuch as the bank employee handles money in great quantities, and faces many temptations. There are certain young men who should never go into banking. This type consists of those who cannot resist the temptation to pilfer. There are those to whom the sight of money is an irresistible temptation that cannot be overcome. In my own bank, at one time, I had a young man who was engaged as messenger. After he had been employed about six weeks we found that he stole the first money he could put his hands on. One day a deposit was received too late to be placed in the money vault and was placed overnight with other valuable papers in the book vault in the basement. This young man was sent down the next morning to get some stationery, and seeing the money on a shelf, appropriated it ($100). It was soon discovered that the money was missing and the theft lay between the boy and the janitor. It took two detectives a day and a half to "break" the boy

into a confession. It is needless to say that such a boy should never seek employment in a bank, and he never would be given a bank job if such a tendency were known to the officials employing him. Therefore I lay down the rule that a bank employee must be honest, and if not, he will not long remain in banking.

Accuracy.—The next essential I would name is *accuracy*. Banking is a mass of detail, each important in its place, and each fitting into the work like the teeth in a cog wheel. One thing done wrong will undo a thousand things done right. For instance, in posting a check for $8.90, it is posted as $9.80 and the work is out of proof. The teller received it as $8.90 and charged it out of his cage in the same amount; but when the bookkeeper's work is checked back with the teller, a shortage is found to exist, and it matters not that a thousand checks were posted right, the one posted wrong will destroy the effect of all the accuracy in the other work. Two errors in a certain bank required upwards of three hundred hours extra work before they were located.

Accuracy is not peculiar to banking—it is essential in every business. If, for instance, the clerk in a department store, in making out a sales ticket, gets the address wrong, it means that the package must be sent to the wrong address, recalled, the correct address ascertained, and a redelivery made, with all the attendant annoyance and costs. Accuracy may cost its price in time and care but it pays—always.

Make your figures plainly—so plainly that there can be no question as to what they are. *Never pass a figure that is in doubt and never make one that is doubtful.* Be correct in your additions and subtractions; making the computations the second time as a matter of habit. Take nothing for granted.

A Regard for the Element of Time.—While all business has in it the element of time, banking is particularly based on a time schedule. The doors open on time and close on time. Negotiable instruments must be presented on time, or risk follows that may prove costly. The mails must go out on time, otherwise checks and other instruments will be late in arriving at their destination, and delay means loss of interest, and perhaps loss of money besides. The schedule of the day must be followed, otherwise the whole force may be detained at night, just as a slow movement in one wheel makes for slow movements in others. The tellers may hold up the bookkeepers and the bookkeepers may hold up the mail tellers; and they in turn may hold up the out going mail

In the chapter on clearing houses it will be seen how clearings are made on the exact minute, and the bank must be ready for this clearing process, otherwise it will not receive payment for its checks and the work of the whole day will be unduly held back.

Promptness is a virtue for its own sake, and the life stories of successful men reveal the fact that the successful business man is the one who keeps his engagements You have no more right to take another man's time than you have to take his money. The busy man will always be prompt in attending meetings and keeping appointments. He expects other men to do the same. He regulates his life by a schedule and like the railroad expects to hold to it.

During a period of about five years the author came intimately into contact with a certain business man who was habitually late. In all that time he never kept an engagement for anything on time. He would invariably be from fifteen minutes to an hour late. He would keep a group of directors in a corporation waiting more than an hour for him to appear and preside. At meetings of

bank directors that were almost vital to him he was, according to habit, late.

Not only did this habit of being late involve his appointments, but it followed him in his engagements to meet notes and pay his bills. The banks which held his paper could never obtain its payment or a renewal on time. His paper was habitually past due. His interest was always in arrears. If he promised to send a check by a certain day, it never came as promised. From a most promising career, he descended to a dismal failure. Whatever he touched he blighted.

If I were to lay down one essential rule, it would be this: Keep every appointment religiously—ahead of time if possible. Make no engagement you cannot meet; and if unavoidably detained, use the telephone. If you owe money, pay it when it is due, or advise your creditor the reason if you cannot. When your note is due at the bank, make provision for it a day or two beforehand. Do exactly as you promise, both as to time and as to money, or have a good reason for failure to perform, and get the reason to the other party in time for him to make his arrangements accordingly. Never stall for time. I have never found a business man who would not be lenient and fair, if his debtors would but "lay their cards on the table," and when they could not meet their engagements, frankly told him so; but as soon as they began to lie and deceive and obtain concessions by subterfuge, the man's fighting blood was stirred to action and he would demand his legal rights. Men do not like to be trifled with; they do admire honesty and frankness in business, and will give and take, when the other fellow shows an honest purpose to do the best he can.

Courtesy.—Much has been said and written about courtesy as a business asset; and courtesy has many definitions and expresses itself in many ways. It

simply means that every transaction shall be done with ease and grace and that the customer shall be pleased. He must not only feel that he has been *served,* but that the service has been willing, efficient and smilingly done. And this is not always an easy task.

Modern business is transacted to a very large degree over the telephone, and the proper and efficient use of this instrument is important. Friends can be made over the telephone and enemies can just as easily be created. Lasting impressions can be given over the wires, both for good and for ill, and the bank man who succeeds in the highest sense knows how to use the telephone to its greatest advantage.

Secrecy.—The bank man learns much of the business secrets of his clients He knows how their bank account is running, how they borrow, how they pay their bills, how they live. The inner secrets of men and families are known not only to the officials but also to the men and women in the ranks. *It is vitally important that all information which is acquired in banking routine be held sacred.* In other words, the information gleaned in the bank should be left at the front door when the day's work is done; and all that is known of other peoples' business should be as carefully guarded as the most personal secrets of one's life.

Dress the Part.—Personal appearances count for much in all lines of business. If you cannot be well dressed, be cleanly dressed. If your clothes are shabby, have them clean. It is no disgrace to wear a threadbare suit; but it is a disgrace to wear a soiled collar. Dress plainly and in good taste. Avoid flashy colors. Buy good clothes and make them last a long time. Keep your shoes polished, your nails trimmed and clean, your linen fresh and your face shaven every day!

Routine.—Inasmuch as banking is a mass of detail and routine work until the bank man reaches an executive position, a liking or an adaptability for routine work is essential. The boy who likes to sell goods should never go into a bank; and the boy who likes mathematics should not try to sell goods. And unless the boy has a liking for keeping books, making figures, adding, subtracting and multiplying, he can never fit into banking

There are certain positions in every bank which are nerve-racking and monotonous. These positions are as a rule shunned. Of such character is the work of the bookkeepers on the customers' ledgers. This work, if in the Boston Ledger form (which see under bank accounting) consists in adding and subtracting constantly. It is not a desirable occupation, but a good training school. It teaches one to be exact, methodical, intensive. It requires concentration of a high degree. The boy who goes through this and keeps his courage has learned a valuable lesson. If the work is done by means of bookkeeping machines, it is largely a mechanical process. This too requires concentration, and is a steady grind. At best the only quality to be acquired is the ability to read names and figures correctly and to operate quickly. The operator gets an intimate knowledge of the checking accounts that will, in other positions, stand him in good stead. I find that ambitious boys shun this part of bank routine on account of its intensity, preferring to do other parts of the work which are more varied in their mental processes. I not only urge the boys, but in some instances compel them to take their turn at this work, knowing that the training they will get will be a good asset in future days. I had a most excellent employee who moved up the line fast. He soon became an assistant in the cage. It became necessary in vacation time to put him back on

the more humble work, at which he rebelled. I finally persuaded him that it is just as much an accomplishment to be able to go down the line and do the more humble work gracefully as to move up the line and do the higher work well. It proved a most excellent process of development and he became one of our best employees.

Collections.—The term "collections" is used to designate such instruments as have the element of time connected with them; and may also include irregular items which have failed of payment in other departments of the bank work. We may classify collections as (*a*)

Commercial Bank, New York,

DATE SENT	PAYER	AMOUNT	WHERE PAYABLE	DUE	ENDORSER
3/31	DISPATCH PRTG & BINDERY CORP	410 13	YOU	4/18	AMERICAN TYPE FOUNDERS CO

PROTEST *if not paid*

THE FAVOR OF PROMPT RETURNS IS REQUESTED UPON THE ITEM HEREWITH ENCLOSED FOR COLLECTION

RESPECTFULLY, IRVING NATIONAL BANK
WOOLWORTH BUILDING, NEW YORK

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Form 17 —Collection letter—time item

outgoing, and (*b*) incoming. The outgoing collections will consist of the following:

(*a*) Notes held by the bank under discount and payable at places other than its own counters. These must be sent out by mail or messenger for collection. In many banks they are handled by the note teller.

(*b*) Notes left by customers of the bank for collection and credit.

(*c*) Drafts, acceptances, etc. owned by the bank.

(*d*) Drafts and acceptances turned into the bank for collection.

(*e*) Irregular checks—those which have not been paid upon presentation, and those found defective or irregular, and which must be given special attention.

(*f*) Coupons from bonds held by the bank as investments.

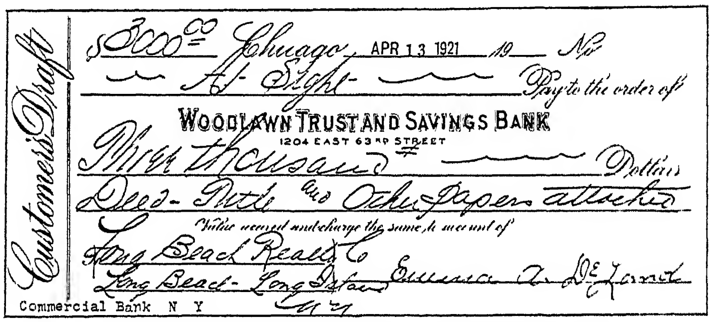
(*g*) Coupons from bonds in collateral loans

(*h*) Coupons from bonds in safekeeping.

(*i*) Coupons turned in by the bank's customers.

(*j*) Maturing bonds owned by the bank and its customers.

(*h*) Special collections, such as savings bank pass books, deeds, mortgages, and other valuable papers to be delivered upon the payment of specified sums.


Customer's Draft

$5000.00 Chicago, APR 13 1921 19__ No.

At Sight Pay to the order of

WOODLAWN TRUST AND SAVINGS BANK
1204 EAST 63RD STREET

Five thousand Dollars

Deed-Title and Other Papers attached

Value received and charge the same to account of

Long Beach Realty Co

Long Beach - Long Island

Commercial Bank N Y

FORM 18—Commercial draft with documents attached

The incoming collections will consist of the same kind of instruments received by the bank from other banks, firms, and corporations for collection.

The essential thing is to have a record of all such instruments handled, so that tracing is easy and reference possible at any future time. Banks therefore record in various ways. Date received or sent; date of instrument, maker, payee, drawee, time, from whom received, papers accompanying, protest or not, amount and fate.

The division of such work as above outlined depends upon the size of the bank. The work itself is quite the same, whether it be done by a highly depart-

mentalized staff, or as part of the day's work. In seeking to build up good will, based upon service to the public, the banking world has assumed many functions hitherto regarded as no part of banking. At the same time banks have taken on various activities as a matter of pure service, for which nominal charges are made and in many

FORM 184½

NATIONAL COMMERCIAL BANK

ALBANY, N Y

We enclose for collection the following items:
Please report by our NUMBERS

Deliver documents or bill of lading only on payment of note
Do not hold for convenience of parties.

	DATE SENT	DUE		ENDORSER	AMOUNT
No 425 To New York	NY 4.9	4	.25	Union Tr Cleveland	204.35

Protest and return promptly all paper unless otherwise instructed by us

FORM 19 —Collection letter—time items

instances are performed gratuitously. Among such services may be mentioned the collection of coupons, notes, bills of exchange, handling valuable papers and securities for customers of the bank and others and for which in many cases no charges are made. The charge for such service is optional, but in such matters exchange has its rightful and undisputed place

Reason for Making Collections.—If a reason were sought as to why a bank makes collections, the answer would lie in three directions: (1) It builds up deposits, (2) it serves the customer; and (3) incidentally produces as a profit the exchange charge if any.

A bank handles two principle kinds of items, cash and time. The cash item is immediately credited to the depositor's account, although a short lapse of time may occur before funds are actually received. In the case of a time item, no funds are advanced until payment has been received, when the amount is credited as a

cash item. In both instances the bank balance of the customer is augmented.

Were it not for banking service in the line of collections, business men would have no other medium than the express companies through which to make collections, and these companies have not the finely organized facilities for such work as have the banks. Where the volume of collections is large, the receipts from exchange may be large enough to pay the operating expenses of the department and show a margin of profit besides

The Time Items Received for Collection may be further classified into: (*a*) Those not yet due. These are notes, bills of exchange, drafts and acceptances which have not yet matured. They must be presented when due, and given more care than cash items in order that presentment may properly be made. Of the same character also are items such as drafts carrying bills of lading, deeds, mortgages, etc. which must have special attention. (*b*) Dishonored items, past due notes, unpaid checks, etc. which must be given more attention than could possibly be given in the departments handling cash items. Wire advice of payment is frequently requested on time items, and such advices cannot conveniently be given in the departments handling cash items. In the latter speed is essential; in the former due care is the predominant characteristic.

In making collections, the bank does not become the owner of the instruments as is the case in cash items It is the depositor's agent, and as such must use due care in selecting collecting agents, and use due diligence in making the collection. Beyond the foregoing it cannot be held responsible until the funds have been received. If anything, more care is given to time items than to cash items, in that more detailed records are made and tracing is therefore much easier.

It is quite customary that when a cash item has failed of collection as such, to turn it over to the collection department for more careful treatment. For instance, a check is returned unpaid as short, uncollected funds, date, or any other reason. It is taken out of the cash work and turned over to the collection department for further presentation. Such department will present the item, it may be, several times, before payment is finally

COMMERCIAL BANK

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DEAR SIR

Please receive herewith for Collection and credit

Kindly acknowledge receipt Yours Respectfully,

Our Number	MAKER	ON WHOM DRAWN	WHEN DUE		AMOUNT		

FORM 20 —Collection letter.

made; or failing in this it may be turned over to the legal department for such action as the law allows. An illustration will be in point: A bank in New York received a check from one of its correspondents as a cash item. It was returned unpaid. It was sent through again as a time item, and inadvertently advised as paid. The maker could not pay the check, and the sending bank refused to allow it to be charged back on the ground that it had advanced funds on the check upon the advice of payment. Nothing remained to do but to "work it out." The bank in error finally adjusted the matter by taking a series of small checks from the maker, dated a week apart. The item first appeared

as a cash item; then as a collection item; and finally as a "suspense" item, being held in *unadjusted items account* until paid. Meanwhile the legal machinery of the bank operated to compel the maker to issue the series of small checks in settlement. He could, of course, have been sued and judgment obtained; but banks resort to extreme measures only when all other methods have failed.

The Collection Process.—It will simplify the collection process to take a single transaction and trace it from start to finish. We will take for the illustration a note received from a customer for collection and payable out of town. When the customer leaves the note he is given a memorandum receipt, either in the form of a special receipt, acknowledging the receipt of the item for collection, or an entry in a special pass book (if he has regular dealings in such matters) or it may be entered in the back of his regular deposit book. The item is then entered on a collection register, on a numbered line, which number will identify it subsequently. The item has stamped upon it with a rubber stamp,

Our collection number 2568 Please report by number

The entries in the collection register are: Date received; date of instrument; maker; from whom received; where payable; amount; time; when due; to whom sent; instructions; fate. Under instructions will be entered "protest" or "no protest," "B. L." (meaning a bill of lading accompanies) "Allow examination" etc.

The note is then stamped with the bank's indorsing stamp and sent in a collection letter to its correspondent. The latter will make essentially the same entries on its

incoming collection register. The item will be listed on the messenger's route list and by him presented to the maker of the note, or the bank at which it is payable If paid, the messenger will turn the amount over to the collection clerk. The item will be marked "paid" in the collection book, and credited to the account of the bank from which it was received. An advice will be sent to the sending bank, advising it that

We credit you this day $ your collection No ..
James Smith

Upon receiving the credit ticket, the sending bank will charge the paying bank and credit the customer. In the outgoing collection book the item will be marked "Paid," with date in the fate column. Should the item be dishonored, it will be protested and returned to the sending bank in the same manner, the protest fees only being charged against the sending bank.

The notes and other instruments *received* for collection are kept in a note file under maturity dates, so that they will have attention when due. Where the party obligated to pay the note cannot be reached by the bank's messenger, a notice is sent advising him that a certain instrument (describing it) is held by the bank for collection. If not paid when due it is protested and returned unless protest is waived.

Recall of Notes.—It is a common practice among business men to give out notes, and instead of allowing the instrument to be presented at the place of payment, take it up by check. In many cases part payment may be made and a renewal given for the balance. It frequently happens that a customer will ask to have a note recalled on the day it is due, either for the purpose of paying it by check or for renewal. It is the universal rule to make these recalls through the same channel the

instrument traveled on its way for payment. And only the owner of the note may ask for its recall. Thus for example: A note is due today, payable in a certain New York bank. The person discounting the note wishes to pay it himself, or seeks to recall it and give a renewal.

No.______ $______

COLLECTION RETURNED BY

COMMERCIAL BANK

New York, N.Y., ______ 191_

To______

Reason for non-payment, if any given stated below.

Form 21 —Collection returned

The proper course would be to deposit the funds at the place of payment and let the note take its usual course. The parties in interest may adjust the matter between themselves by a discount of the renewal note and check to settle the difference. But in many cases the advice is received too late to make such a deposit or otherwise take up the note at its place of payment. Upon advice from the owner, the bank will advise its correspondent

to return the note without protest; the correspondent in turn will advise its correspondent, and so on until the note itself is reached. It is not allowable to take a short cut and avoid the several telephone or telegraph messages, for the reason that if the note were not to go back through the original channel, the records of the interven-

COMMERCIAL BANK

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Mr

Please to take notice that a draft on you drawn by for $ will be held at this bank for collection until .. 3 p m.

COMMERCIAL BANK

FORM 22 —Notice of draft received for collection

ing banks would not be complete and there would be outstanding items to account for. Therefore banks will only honor recalls when received from their own correspondents. Whatever route the instrument took on its way to payment must be the route for its recall.

The Messenger's Duties.—The messenger is charged with what he takes out and must account for all papers and documents, either in cash or by the return of the papers taken out. His route is covered according to a program laid out by the messenger in chief and is so arranged that the maximum of ground may be covered with a minimum of time and expense. He is supplied

with a wallet with lock, which is generally fastened to the body with a chain enclosed in leather He is supplied with notices of various kinds, such as left out notices, arrival notices, notices of drafts presented, cash envelopes, etc., and a rubber stamp for receipting for paid instruments.

Drafts in the possession of the messenger should be presented to the party drawn on and reasonable effort should be made to find the proper person. If the drawee cannot be found, a "notice of draft held" is left, so that he will have notice that the instrument is in the bank awaiting payment. One presentation is sufficient to bind the party primarily liable.

Instruments drawn on partnerships may be presented to either partner. Those drawn on corporations should be presented to the cashier or treasurer.

Reason for Return of Items.—Many banks make it a practice to give the reason for the return of all instruments handled by them, by checking alongside a list of reasons the one applicable. This slip is returned with the dishonored instrument and explains the reason for the return It is a helpful practice. The messenger should make such notation on all papers returned by him unpaid.

Where the instrument is presented for *acceptance,* care should be taken that the acceptor is authorized to make the acceptance. The individual drawn on has, obviously, such right. In partnerships, either partner may make an acceptance. In corporations, the treasurer is the logical one, although any executive officer may do so.

Payment for Collections.—Payment for collection items should be in cash or certified check, unless the party paying the same is so well known, or is a customer of the bank, when an uncertified check may be received. Papers should never be left with the drawee unless pay-

ment has been made or by special instructions from the bank.

Where two items are paid by the same party with one check, notation should be made on the check of the collection numbers, or drawers names, so that the bank records may be reconciled

IRVING NATIONAL BANK
Woolworth Building - - New York

DATE ENTERED		PAYER	PAYABLE AT	DUE	AMOUNT
4/11	2274	M S O CONNELL	COLUMBIA TRUST CO HARLEM BRANCH	4/14	207 04

TO

Commercial Bank
New York,

1

The item described herein IS TO DAY APR 14 1921 PLACED TO YOUR CREDIT

FORM 23 —Notice of payment of collection item

Where documents are attached, they should never be released to the drawee unless payment has been made or acceptance of the instrument has been obtained, where delivery is permitted upon acceptance as distinguished from payment. Instructions which accompany the collection instruments should always be followed. Changes in any instrument presented for collection should not be permitted.

Cash received should be placed in separate envelopes for each party, so that in case counterfeits are included they may be charged back. It is well to count and seal the money in the presence of the one paying the instrument.

Checks received in payment should be drawn on local banks, unless advised by a bank officer otherwise. They should be made payable to the bank. The amount should be correct.

Time items are left for examination and a "left out" notice is returned to the bank. The left out items are collected the following day. Upon the return of the messenger from his route, he reports to the department which sent him out and turns in his route sheet. He must account for all items taken out, either in cash, checks, returned items or left out slips.

ADVICE FOR

IRVING NATIONAL BANK
Woolworth Building New York

Commercial Bank, New York,

All notes and drafts are received at customer's risk for collection subject to final payment.

DEPOSITORS DATE OR NUMBER	DATE SENT	PAYER	AMOUNT	DUE	DOCUMENTS	INSTRUCTIONS
2155	3/24	MICHAED SMICED	400 00	4/18		PROTEST

COLLECTING BANK: RIDGEWOOD NATL BANK, RIDGEWOOD Y

EXPENSE

AMOUNT CREDITED

P The Item described herein APR 19 1921 IS TO PAY PLACED TO YOUR CREDIT

FORM 24 —Notice of note paid and credited

It seems hardly necessary to observe that papers taken out by the messenger should be given thoughtful attention, for the loss of a single piece of paper may cause loss, and certainly annoyance to the bank. The messenger must realize that he is handling valuable documents, belonging to other people, and which carry certain rights with them; and a loss of the wallet or any of its contents may be a serious thing. White paper can carry information and facts which may have caused a great deal of labor to prepare and which cannot be replaced without a great deal of effort. For instance, the loss of a bill of lading may cause delay, and perhaps the loss of a shipment of a lot of perishable merchandise; and to obtain a duplicate or substitute necessitates certain routine that is annoying. Carefulness is an asset in any business.

Time Items.—Time items are presented to the drawee as soon as received by the bank They are if necessary left in the possession of the drawee for a short time, not over one day, for examination. If accepted the instrument is taken back to the bank and held until maturity when it is presented for payment. In some cases the instructions are to release documents upon *acceptance* and in others only upon *payment.* Where the presentment for acceptance is made by the city collection department, the presentation for payment may be made through the note teller. If loans are made against the instruments, they will be turned over to the discount department and held in the discount department between their acceptance and their payment, and by the discount department turned into the collection or note department for collection at maturity

City Collections.—Items which are payable within the limits of the bank's home city are called "city collections" and are made by messenger. This includes the collection of certain cash items as well as collection items. Banks which are not members of the clearing house pay their checks by drafts on their correspondent banks in the financial center or on the Federal reserve bank. Such checks must be presented over the counter of the paying bank, by messengers. The messengers also present the irregular items, coupons, and other time items for payment. Items payable at business places are presented by the same force. Where the bank is large enough the presentation of notes and coupons is made through the note teller's department and not through the collection department. The city collection department will under such circumstances, collect all items with the exception of notes and coupons, of whatever nature they may be.

In a large New York bank, the city collection department collects large cash items that cannot reach the transit department in time to be sent to the Federal reserve bank for immediate credit While such messenger service is costly, the saving in interest more than offsets the cost of personal collection. Also this department collects certain classes of items not handled by the Federal reserve bank, or the clearing house. The items to be presented are indorsed with the "paid" stamp of the bank and listed on route sheets in duplicate. These route sheets have the name of the party to whom presentment is to be made, the amount and fate. After presentation the route sheets are turned in, with unpaid items and returns for those honored. The fate of each item is indicated together with memorandum of the kind of funds received.

Dishonored Items.—The dishonored item is listed in a returned item book with the reason for the return, with a more or less complete description of the item. It is then protested and charged back to the customer from whom it was received. Where an item fails of collection as a cash item, it is generally put through the work as a collection item before finally returning to the customer; although it would be charged to his account as soon as payment was refused.

In the city banks the greater part of the collection items come through the mails from correspondents. These are turned over to the collection department from the mail department, before or after acknowledgment is made of their receipt. Another source of such items is the import department, where foreign drafts are received on account of international transactions.

Incoming Collections.—Incoming collections are recorded on sheets or collection registers, with the following details: Date, sender, maker, drawee; collec-

tion number, amount, documents, instructions, and fate. The items may be grouped or separate sheets used for the various kinds, as desired. After the items have been listed on the collection sheets, they are transcribed on loose forms, making several carbon copies. A typewriting machine is now made that will feed four or

NATIONAL COMMERCIAL BANK AND TRUST COMPANY
ALBANY, N Y
WE BEG TO ACKNOWLEDGE RECEIPT OF FOLLOWING UNPAID ITEM DEC 28 1922

	YOUR DATE	DESCRIPTION	REASON	AMOUNT
To New York	12.27	1226	PRO	34.60
			FEES	1.25

FORM 25.—Acknowledgment of unpaid item returned

five sheets with carbon paper in between, so that several duplicates may be made without inserting the carbons It automatically removes the carbon after making the impressions. These forms are so worded as to act as: (1) Acknowledgment; (2) forwarding slip; (3) file for customer, (4) credit ticket, (5) maturity slip. Number 1 goes back to the source of receipt; number 2 goes with the item, number 3 is filed under customer's name; number 4 becomes a credit ticket when paid; number 5 is filed under due date for presentation purposes. After being entered thus they are sent out by messenger for collection. Stocks and bonds are entrusted to the more experienced messengers, usually mature men Outgoing collections may also be recorded on similar carbon forms

Non-payment.—Where items are dishonored, the instructions of the customer come into play. In many banks there is a rule that items under a nominal amount —say $10, are not to be protested; while on items of larger sums, such as $500 and over telegraphic advice is given of non-payment. Practically all collection items

have instructions accompanying. Where the customer does a regular collection business standing instructions may be given which apply to all his business.

FOR COLLECTION H

FIRST NATIONAL BANK
PHILADELPHIA, PA.

COLLECTION DEPARTMENT

To Commercial Bank, New York

Date 4/15/21

Please advise each item separately giving our collection number and letter date.

OUR 84081 NUMBER

OWNER	Owner's Date or Number	PAYER	PLACE PAYABLE	DUE	PRO	AMOUNT
KEYSTONE TYPE FOUNDRY SUPPLY HOUSE INSTRUCTION 1	4/15	SO SIDE OBSERVER CO	ROCKVILLE CENTE N Y	4/15	X	$ 50 00
						INT 1 00
						51 00

Do not protest items marked X on this letter and those bearing (N P 3 20) stamp or similar authority of a preceding endorser

Deliver documents only on payment unless otherwise instructed.
Do not hold for convenience of parties.

FORM 26 —Collection letter with explicit instructions

FORM NO 134 NO 9360

VICE PRESIDENTS: LOUIS J WEIL, FRANK E WHEELER, ARTHUR D WOLF
PRESIDENT: SYDNEY H HERMAN
CASHIER: GEORGE D CONNLEY
ASSISTANT CASHIERS: WILLIAM MINTON, MORTON FREDERICK

UNION EXCHANGE NATIONAL BANK
OF NEW YORK
FIFTH AVENUE AND 21ST STREET

NEW YORK, 4/ 11/ 1921

Commercial Bank, New York, N.Y

Please acknowledge receipt of all letters BY [illegible]
Unless otherwise directed, follow instructions PRINTED ON OR ATTACHED TO items enclosed
Protest and return WITHOUT DELAY all dishonored paper, EXCEPT ITEMS MARKED X
Wire all unpaid or unaccepted items over $500
ITEMS MARKED X DO NOT PROTEST

ENDORSER		AMOUNT		BANK
A Rosenberg Co	YOU	185	70 c	
		185	70 c	
PLEASE WIRE PAYMENT OR NON PAYMENT IMMEDIATELY				

FORM 27 —Collection letter with instructions

Arrival Drafts.—A great many drafts are drawn payable upon arrival of the goods. Such items are regarded as time items. As soon as received they are presented to the drawee, or notice given him that the draft has

arrived. It is presumed the customer desires the goods and will take up the draft as soon as the goods arrive in order to avoid demurrage charges. In order to keep the drawee informed, some banks send out weekly notices of the drafts in possession awaiting the arrival of the goods. Automobiles are shipped largely upon arrival drafts; but inasmuch as an arrival draft is a time draft and carries documentary stamps, some of the large automobile firms are using the demand draft which requires no stamps, with instructions to hold until the arrival of the goods.

Country Collections.—Many banks find it necessary to operate a country collection department which handles non-cash items payable out of town. Of such are notes, acceptances, bills of exchange, past due checks, coupons, etc. These are recorded in the out of town collection register with the same details as other collections, and sent out with letter of advice in time to make proper presentment on the due date. This is usually done a week or ten days in advance of maturity. One distinction prevails in this respect, namely; such items as are sent out for collection are not charged against the account of the bank to which they are sent until the latter advises that payment has been made In sending out cash items they are immediately charged to the correspondent's account.

The carbon system for recording collections out of town is as meritorius as for city collections. Several carbons are made at one impression, describing the instrument by date, maker, payee, from whom received, amount, maturity, time, etc. Two copies go with the item, one being the letter of transmission and the other the receipt of the bank to be returned in acknowledgment, one copy is filed under due date, another under owner's name, one serially, another being the credit ticket upon

receipt of advice of payment. When payment is advised the account of the collecting bank is charged, and the customer is credited; or if cashier's check is received, the customer's account is credited with the proceeds, and the check put through for payment.

The smaller banks do not find it necessary to consider collections as a feature of their business, although such items should be given the same attention as if the bank were more highly organized. Usually this work devolves upon one of the clerks who gives collections attention in connection with many other duties. In such banks collections are not numerous, but this is not to say they are not important.

City Notes and Acceptances.—With the tickler as a guide, notes and acceptances falling due on the following day are prepared for collection on the day previous The instruments are taken out of the files and checked with the listings on the maturity book The tickets are checked with the instruments to be sure that the details have been correctly entered. The items are entered in the route book or upon route sheets, and may again be checked with the maturity book to act as proof that all items have been accounted for They are then sent out by messenger on the day due and are collected as already set forth.

Collections Payable at the Bank.—The making of a note payable at a bank, or making an acceptance payable at a bank is equivalent to an order on the bank to pay the same on the due date.

It is not necessary to obtain instructions from the maker or the acceptor as to its payment, for the act of making or accepting is the bank's warrant to pay on the due date. Therefore, unless the maker or acceptor has lodged a stop payment against the instrument, which he has a right to do, the bank may charge his account the

same as a check. Should the account not have sufficient balance, the bank should communicate with the maker or acceptor in order that there may be no injustice done through oversight.

Collections Payable at Clearing House.—Where notes are payable at a bank which is a member of the clearing house, it is customary for the bank honoring the instrument to accept or certify it, after which it is collected through the clearing house with the checks on the next day. Such items are presented to the paying bank in the morning, and if honored are certified and returned to the presenting bank. If dishonored, the maker may be notified, and he has until three o'clock to make the paper good.

Settlement for Collections.—When a note has been collected for a customer, and has not already been passed to his credit as a discount, the amount is credited, with notice. In such cases the duplicate ticket made out when the item was first entered in the collection process becomes the credit ticket.

This is sent to the bookkeeper who makes the proper entry. If settlement is to be made by cashier's check, the credit ticket becomes the requisition for cashier's check. One of the duplicates made at the beginning of the process becomes the customer's letter of advice Unpaid collections in the form of notes and acceptances are returned to the owners through the same channels as received, and if protested, the fees are charged back.

Collection of Coupons.—The collection of coupons for clients and for its own account has always been a part of bank service. These coupons are received from various sources, namely:

Coupons left for collection and deposit
Coupons from the bank's investments.

Coupons from the securities for safe keeping.

Coupons from trusts.

Coupons from securities in collateral.

Inasmuch as coupons are essentially cash, being payable to bearer, they must be given more care than other bank collections. Since the Liberty Loan campaigns placed millions of bonds in the hands of private individuals, government coupons have been passing through the banks in large numbers and in large amounts.

The work of collecting coupons is so heavy in the city banks that it is given a department by itself and at times the work is extremely heavy, particularly in January and July, which are the favored months for coupon payments. In other banks this work is made part of the duties of a clerk who includes it in his daily routine The coupons as received for collection must be accompanied by the proper blanks for income tax purposes. Coupons from Liberty bonds and municipal issues, as well as coupons from securities held by corporations do not require these tax blanks. All others must be in due form. The coupons should be enclosed in coupon envelopes, each issue by itself, with the name of the debtor, place of payment if known, owner, due date, number, amount of each coupon and total. Coupons as received are listed in a coupon collection book, which gives the name of the paying company, due date, the number of coupons, the amount, the owner, disposition of proceeds. Coupons as received are carefully checked with the envelope records to see that the coupons are as stated both in number and amount and that they are due or about to become so. After being entered in the receipt book credit ticket is made out in duplicate, advising the sender of the credit and forming the basis of the posting credit in the ledger account. Inasmuch as most coupons are now payable "at the fiscal agency

of the company in New York" or other large city, the collecting bank must know where each company meets its coupons. Lists are made up of these fiscal agencies and kept revised from time to time for presentation purposes. The coupons are then sorted according to place of payment and route sheets made up for the use of the messengers in making collections. The income tax

ACKNOWLEDGEMENT RECEIVED

JC.

IRVING NATIONAL BANK

Commercial Bank

New York. 4/20/21

Coupons returned unpaid

NAME	REASON	AMOUNT
City of Paris	Use form 1001-Arev.	60.00
do	do	60.00

FORM 28 —Coupons returned for income tax form

certificates are frequently incomplete or on the wrong blanks and must be returned for correction. It is allowable for banks to act as collecting agents and to substitute their own certificates for the originals, and the city banks frequently substitute the correct forms for the incorrect and advise their correspondents that they have done so.

In sorting the coupons they may be classified into. (*a*) Coupons due, and (*b*) coupons not yet due. Coupons not yet due are entered under their due date in a collection register similar to promissory notes for future attention. On account of the magnitude of the work at certain periods collecting banks request that coupons be sent in advance of their due date so that delays may be avoided when the due date arrives.

The coupons having been proven, credit tickets made out, income tax certificates examined and corrected

where necessary, the place of payment indicated on the envelopes, and the routes classified for the messengers' convenience, they are ready for presentation. The coupons for each company are enclosed in an envelope, the amount indicated thereon and the amount for each paying agent also grouped so that one presentation is necessary. The total of the route sheets, which show the amount taken out on each route in detail, must agree with the coupons receipts for the period covered by the presentation, which acts as a proof of the work of sorting and listing. Some paying agents (trust companies or trust departments of banks) require coupons to be presented in their own envelopes, for the sake of uniformity. In such cases the original envelopes are retained by the bank making the collection and filed for a length of time for record purposes

The coupons and route sheets are now ready for presentation to the paying agents. This is done by special messengers who are charged with the amount taken out on the route sheets and must account for the same, either by returning the amount charged out, or the unpaid coupons. Where the paying agent withholds the income tax, the amount so held out is deducted from the remittance charge out and charged back to the source from which the coupons were received For this purpose the various lots of coupons are given identifying numbers, which are duplicated on the income tax blank, so that each envelope originally received, together with its accompanying income tax blank will have a distinguishing number. When a charge back is made, its source is known by these numbers. The credits are then checked out with the returns and in some banks turned over to the note teller or collection department for credit and advice. In large banks the coupon department will make its own proof and credits.

Maturing bonds are treated in a manner similar to coupons except in the matter of enclosures in envelopes The bond records are kept by numbers so that each bond may be traced through the records and into the mails.

Inasmuch as New York is the financial centre of the country, a great many corporations have their bonds payable at New York banks and trust companies. These banks maintain large and well organized coupon collection departments These departments operate along lines similar to the city collection department.

Unpaid Coupons.—Coupons are not always paid, due to several causes, the most frequent being some irregularity, such as wrong date, sent to wrong paying agent, not yet due, and defective income tax certificates. Care should always be taken that coupons sent in are about to become due. Frequently the wrong coupon is cut from the bond in error, and not discovered until it reaches the paying agent The most frequent cause of return is incomplete income tax certificate, obsolete or wrong form, making it necessary to hold back payment until the error can be corrected The collecting bank will often supply the correct form, or alter the erroneous matters, with advice to the owner or collecting bank from which they were received.

Coupons sent out for collection are entered in a coupon collection record giving the date received, the owner, name of company, number of coupons, amount, where sent and fate They are sent out under registered mail, and the same carbon forms may be used as in making other collections, which see. When payment has been made the credit ticket will be received from the collecting bank and the amount credited to the owner and charged to the correspondent bank.

Exchange Charges.—In making collections, the element of exchange has its proper place. The service is real, special and involves more care and labor than the handling of cash items. Practically all collections carry exchange and this charge is deducted from the credit when passed to the customer's account and credited to exchange account. The fee is discretionary and more or less uniform among banks. In certain clearing house centers the exchange rate is agreed upon between the banks; while in country banks the charge is optional.

Receipts of the Collection Department.—The receipts of the collection department, being of the same nature as those received by other departments of the bank follow the same course, namely: Cash to paying teller; out-of-town items to transit department, checks on itself to bookkeeping department, etc. Items held over for any reason are kept within the department's control for future treatment.

CHAPTER XVI

PROTEST AND NOTICE OF DISHONOR

It is required in the law that negotiable instruments shall be presented at the time, at the place indicated, and to the party obligated to pay the same. The process of *timing* negotiable paper to determine its maturity will be found discussed under the caption "Timing Notes." Where a place of payment is stated, as must be the case in bank checks, the instrument must be presented at the bank, but in promissory notes and bills of exchange the place of payment is sometimes omitted. In this instance, the instrument is payable at the place of business of the maker or acceptor. If he has no place of business, it is payable at his home; and if he has no residence, it is payable wherever he may be found.

Checks are, as a rule, required to be presented during the established banking hours. Where the instrument is presented at a place of business, it must be presented during the established hours of business; and where it is presented at a private residence, it must be presented before the usual hour of rest, giving cognizance to the habits and customs of the community When an instrument has been properly presented for payment and payment has been refused, *notice of dishonor* must be given the drawer and each indorser in order to charge them with liability on the same, unless notice has been waived or otherwise dispensed with

The giving of notice of dishonor is dispensed with when, after the exercise of reasonable diligence, it cannot be given or does not reach the party sought to be charged.

The one who is giving the notice must use due diligence in ascertaining the address of the party sought to be charged, and also in giving the notice. If he did use such care, and the notice fails to reach the party, the latter is charged nevertheless. If due care is not used, then the party is discharged. What is due care, or diligence, cannot be definitely stated. It depends altogether upon the circumstances of the transaction.

There are circumstances where notice of dishonor is not required to charge a drawer with liability, as, for example, where the drawer of a check has no right to expect that his check will be honored. A check is presumed to be drawn against sufficient funds, and the drawer is presumed to know the condition of his account. Consequently, if he draws a check knowing that he has insufficient funds to meet it, or no funds at all, and there is no valid agreement with the bank to honor checks so drawn, he has no right to expect anything other than that his check will be dishonored. He will not be permitted to defend an action against himself on the check on the ground that he received no notice of dishonor. If the drawer has reasonable ground for believing that the check will be paid, he is entitled to notice notwithstanding the check is drawn against insufficient funds

Presentment for Payment.—*Presentment for payment* is one of the steps which the holder of a negotiable instrument must take if he would charge the drawer and indorsers with liability. If he fails or neglects to present the instrument for payment, the indorsers will, in the absence of special circumstances, be released from liability. The general rule is that a check or a demand bill must be presented for payment within a reasonable time after its issue. The failure to so present the instrument discharges the drawer only to the extent of the loss which he may have suffered by reason of the holder's

neglect. Such a loss is suffered by the drawer of a check when the drawee bank fails during the time the holder retains possession of the check A check might be good when drawn, and for a period of time thereafter, but if the holder delays presentment and the bank fails, the maker would be released by reason of the delay

In presenting a check for payment it is not necessary to present the same to the paying teller for cashing; it is sufficient if it be presented for deposit and the credit is refused. The check may be presented to anyone authorized to make payment, and no particular officer need make the refusal.

Reasonable Time.—In determining what is a reasonable time, regard must be had to the nature of the instrument, the usage of trade or business with respect to such instruments, and the facts in the particular case. The reason for this rule in the case of a check, is that a check is not designed to circulate as a medium of exchange and should be presented with due diligence consistent with the attending circumstances

It is held generally that in order to make a presentment within a reasonable time, where the holder and the drawee bank are in the same place, the check should be presented before the close of banking hours on the day after its receipt. If the check is not presented within such time and a loss results thereby, as where the bank fails in the meantime, the drawer is discharged.

When the check is on an out of town bank, the holder is of course, given a greater length of time within which to make presentment Just how much time he is entitled to depends upon circumstances. The distance which the check must travel, the facilities for sending it, and the customs and usages of the banks handling checks in such cases, must be taken into consideration. The general rule is that the person receiving the check, in

the absence of special circumstances, must forward it for presentment not later than the day after its receipt. The agent to whom the check is sent must in turn forward it not later than the day after its receipt. Under this rule, banks quite generally forward all checks the same day as received, and all checks in their hands at the close of business go forward before the close of business Special circumstances may, however, make it necessary to hold the check over until the next day, and under the above rule this would satisfy the law as to due diligence

Circuitous Routing of Checks.—Under the old regime, checks were often sent by round-about methods to escape exchange charges, but under the Federal Reserve System more direct collections are now made. If the bank receiving the check has no correspondent in the place where the check is payable, it should forward the check in such manner as will make presentment without unnecessary delay. Circuitous routing of the check is held improper, and forwarding a check thus will have the effect of discharging the drawer where the check is not paid upon presentment, if it appears that the check would have been paid if it had been presented in a more direct manner.

What is required of banks in check collections is reasonable care and due diligence, taking into consideration the nature of the check and the usages of banks. And where the check goes through a series of correspondents, this will be held proper if such is the established custom, and in keeping with accepted banking practice. Thus, a check was received in Philadelphia and drawn on Greenville, Ala., on Dec. 12, after banking hours. It was deposited the next day. This bank, instead of sending the check direct to a bank in Greenville, which would have made presentment on Dec. 17, sent it to another bank in South Carolina, which forwarded the

check to a bank in Montgomery, Ala. The latter sent it to Greenville and it was presented on Dec. 19, one day after the drawee bank failed. There was no proof to show that this was the established custom in making such collections, or any previous dealings between the parties. Judgment was given the payee of the check because of the undue delay in presenting

Presentment through Clearing House.—In the larger cities the custom is general to make presentment of checks through the clearing house on the day after their receipt. Banks that join these associations agree to make their presentations thus, and the courts sustain such practices as necessary. In a New York decision the court said:

> The usage of trade and business has become incorporated into the banking business of the state and country and would be seriously affected if immediate presentment to the paying bank were required . Bearing in mind the vast number of checks daily used in the City of New York, it is apparent that, if the banks and trust companies of New York were required immediately upon their receipt, to present deposited checks to the banks upon which they are drawn for payment, confusion amounting almost to chaos would be the result

Presentment of Certified Checks.—The rule requiring the presentment of a check within a reasonable time after its issue in order to charge the drawer, applies to a check that has been certified at the instance of the drawer before its delivery to the payee, as well as to an uncertified check. And as in the case of an uncertified check, the drawer is discharged by a neglect on the part of the holder to make due presentment, only to the extent of any loss that the drawer may suffer as a result of such neglect. But, as regards the drawee bank which has certified the check, demand may be made at any time within the statute of limitations. Where the check is certified at the instance of the holder, the drawer and

indorser are thereby discharged and the question of presentment for the purpose of holding them liable does not arise.[1]

Presentment of Other Instruments.—Presentment of bills of exchange, acceptances and promissory notes must be according to their tenor. They must be presented at the place named on the day of their maturity. They must be presented to the one primarily liable thereon. If they are payable at a bank, they should be presented at the proper window or through the mails or clearing house or by messenger before the close of business on their due date. If payable at a place of business, they must be presented to the maker or acceptor during business hours. If payable at a private residence they must be presented to the maker before the usual hour of rest on the due date. If payable at the office of a corporation, they must be presented to the cashier or treasurer as the proper financial officer. Paper executed by a partnership may be presented to either partner during business hours.

Protest and Notice of Dishonor.—The term *protest* includes all the steps necessary to fix the liability of a drawer or indorser upon the dishonor of commercial paper. It is necessary only in the case of foreign instruments (those drawn in one country and payable in another, or in this country, those drawn in one state and payable in another). Protest may, however, be made on any instrument.

Protest is not only necessary to charge the indorsers and the drawer, but is prima facie evidence that the instrument has been presented for payment and has been dishonored. Such evidence is valuable in event of litigation, and no further proof of the fact of presentment and dishonor is necessary.

[1] Brady, "Law of Bank Checks," p 110.

The *practical* reason for protest is to give the parties immediate notice of the non-payment of checks, notes and bills of exchange, so that their business dealings may be guided accordingly, and that they may take immediate steps to protect themselves from loss

Process of Protest.—When the presentment has been duly made and payment refused, it is the duty of the notary to make a "notation of protest" in his protest record. This describes the instrument in full, by maker, date, amount, time to run, due date and parties thereto.

The *certificate of protest* is then made out This is attached to the instrument.

The *notices of protest* are then made out and mailed to the parties within the time prescribed in the law.

Time of Notice.—Where the party giving notice and the party receiving notice reside in the same place, notice must be given within the following times

1. If given at the place of business of the party to receive notice, it must be given before the close of business hours on the *day following dishonor*

2. If given at his residence, it must be given before the usual hours of rest *on the day following.*

3. If sent by mail, it must be deposited in the post office in time to reach him in the usual course *on the day following.*

Where the party giving notice and the party receiving notice live in different places, the notice must be given within the following times.

1. If sent by mail, it must be deposited in the post office in time to *go by mail the day following the day of dishonor*, or if there be no mail at a convenient hour on that day, by the next mail thereafter.

2. If given otherwise than through the post office, then within the time that notice would have been received in due course of mail, if it had been deposited

in the post office within the time specified in the last subdivision. (Negotiable Instruments Law, Sec. 174 and 175)

Where the notice is duly addressed and deposited in the post office the sender is deemed to have given due notice, notwithstanding any miscarriage in the mails.

The term "post office" includes any branch post office or any letter box under the control of the post office department.

Notice to prior parties:

The party who receives the notice has the same time for giving notice to antecedent parties that the holder has after dishonor.

The general rule is to give notice of dishonor by a notary, who is either in the employ of the bank, or who does the notarial work for the bank. In the smaller banks he is usually an officer.

The notice may be in writing, or merely oral, and in terms may be in any terminology that will identify the instrument, and indicate that it has been dishonored. It may in all cases be given by delivering the notice personally or by mail.

Where protest cannot be made by a notary, it may be made by any reputable citizen of the place where the instrument is dishonored, in the presence of two or more witnesses.

Notice—to Whom Given.—The notice may be given to the party himself, or to his agent.

If the party be dead, the notice must be given to his personal representative, if there be one, and he can be found with reasonable diligence. If there be no representative, notice may be sent to the last known place of business or residence of the deceased.

Where the parties to be notified are partners, notice to any one partner is notice to the firm, even though

the firm has been dissolved. Where the parties are jointly on the instrument, and are not partners, notice must be given to each of them, unless one has authority to receive notice for the others.

Where the party to be charged is bankrupt, or is insolvent, or has made an assignment for the benefit of creditors, notice may be given to the party himself or his trustee or assignee.

It is the common custom among banks to address notices of protest to their last indorser, and to include a notice for each prior party. Stamps are enclosed with the notice and the one receiving must forward the notices to prior parties within the times already herein specified.

Where Notice Must Be Sent.—If the party has added an address to his signature, the notice must be sent to that address. But if he has not given an address, the notice must be sent:

1. Either to the post office nearest his place of residence, or to the post office where he is accustomed to receive his mail;

2. If he lives in one place and has his place of business in another, the notice may be sent to *either place;*

3. If he is sojourning in another place, notice may be sent to the place where he is sojourning.

If the notice is actually received by the party, within the time specified, it will be sufficient although the notice was not sent in accordance with the requirements above mentioned.

Notice May Be Waived.—Notice of dishonor may be waived, either before the time of giving notice has arrived, or after the omission to give due notice, and the waiver may be expressed or implied

Where the waiver is part of the instrument and embodied therein, it is binding upon all parties, but where

it is above the signature of an indorser, it binds him only This waiver of protest is deemed to be a waiver not only of a formal protest, but also of presentment and notice of dishonor. Notice of dishonor is dispensed with when, after the exercise of reasonable diligence it cannot be given to or does not reach the parties sought to be charged.

Notice Need Not Be Given to the Drawer.—(1) Where the drawer and drawee are the same person;

2. Where the drawee is a fictitious person or a person not having the capacity to contract;

3. Where the drawer is the person to whom the instrument is presented for payment;

4. Where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument;

5. Where the drawer has countermanded payment

Notice need not be given an *indorser*

1. Where the drawee is a fictitious person or a person not having capacity to contract, and the indorser is aware of the fact at the time he indorsed the instrument,

2. Where the indorser is the person to whom the instrument is presented for payment;

3. Where the instrument was made or accepted for his accommodation.

Protest Fees.—When an instrument is protested, there is usually a notarial fee. This varies, and runs from 50 or 75 cents up to about $3. The postage is additional, and the amount charged is largely a matter of custom. These fees sometimes are allowed to the notary in some banks, while in others they are turned into the bank and credited to protest account. In the large banks, where dishonored instruments are in large numbers, these fees amount to large sums in the course of the year; and even in the small banks are of considerable amount. It is the author's opinion that these fees should not be given

to an officer as a bonus or an emolument, even though the work of protest takes part of his time. He should be given a salary commensurate with his duties, and any fees that may come to him should be a part of the bank's earnings.

Where protest is required, there is no doubt that the party so charged is liable for the fees, and the usual course is to charge back the amount plus the fees, until the instrument reaches the maker, who in the end pays the same. But where protest is not necessary, the decisions are not uniform as to the right to collect these fees As a matter of fact they are as a rule collected.

To be absolutely safe, the presentment must be made by the notary who executes the notice of protest; inasmuch as the decisions are not in agreement as to whether this may be done by a deputy or clerk. It is generally held that the fact that the notary holds stock in the bank owning the instrument, or is an officer, does not disqualify him in making protest. If the instrument has been lost protest may be made on a copy or written description thereof.

CHAPTER XVII

BANK ACCOUNTING

Accounting is an exact science, and in no branch is this statement more easily provable than in banking The books of a well-managed bank are always in balance Every dollar received must be accounted for, and where the funds involved are represented merely by book entries, exactness must rule nevertheless. While accuracy is desirable in all branches of business, in banking it is indispensable. No banking official who is entitled to the designation banker, and no employee who is worthy of a place in a bank can rest content unless he knows his work is in proof. It is a most excellent sign of accounting character when the employee who has a difference in his work worries to the point of exhausting every available means to find it. The supervising authorities are also concerned about this feature of banking, and should not permit any bank to be run in a careless manner, for the safety of the funds under their care demands that the bank's accounting methods shall be complete, comprehensive and correct.

The reasons for accuracy are many. It is a virtue in itself; but in banking the chief reason is that the bank handles other people's money, and should be more careful with its records than if it were a private corporation or an individual matter. What a man does with his own property is his own business; what he does with another's is not.

Banking and business are so closely interwoven that the bank records become the records of the business world.

Many business men depend upon their bank records to keep control over their business affairs, and these records are frequently brought into court for evidence, and must therefore be accurate, complete and self-explanatory. It is marvellous how much information may be gathered about a business matter from bank records. A bank check is at the same time a most dangerous accuser and the most perfect defense depending upon whether it is used for or against us. Such records are frequently brought into court years after they have passed through the books, and generally speaking a bank should be able to trace every transaction handled by it, and prove from original sources the history of each piece of paper going through its hands. That this requires constant thought and most careful work on the part of all concerned goes without saying.

The interlocking of one bank with another in respect to their mutual business is so intimate that disorder in one leads to disorder in the other. Each must be in agreement with the other. Each department, or where departmental operation is not possible and individual work obtains instead, each employee must do his work correctly or the whole accounting machine is thrown out of true. It is not because an error may cost the bank a few dollars that accuracy is insisted upon, but because it disrupts the smooth working of the whole bank. The best lesson any bank clerk can learn is that he must find his own mistakes, and if trivial and inexcusable errors cost him hours of overtime work, he will learn that inaccuracy costs a price he must be willing to pay in toil.

Moreover, every bank transaction is, generally speaking, involved in banking law; and unless the law in the case is observed, law suits and losses may ensue. For instance, the law requires negotiable instruments to be

presented at the time they are due; and if the time be inaccurately figured the law cannot be satisfied and losses may follow. The instructions of the sender must be observed, or loss may ensue. The law requires due care in such matters. For example: A certain bank in New York received a draft with a bill of lading attached, to be delivered only upon signing a conditional bill of sale for an automobile. The clerk received the funds for the draft, delivered the bill of lading, and did not obtain the signature of the drawee on the bill of sale. The drawee obtained possession of the car and placed a chattel mortgage upon it. The bank afterward discovered the error, but it was too late to make correction, and this lapse from due care cost it nearly two thousand dollars

As a matter of fact some of the most dangerous responsibilities of banking are as a necessity placed upon the shoulders of inexperienced and low paid clerks The stop payments, uncollected funds, compliance with instructions in collections are frequently passed upon by the junior clerks, and any miscarriage may lead to costly results. The responsibilities of banking are not all assumed by the executives, and constant and consistent supervision must be given the clerks in the ranks if a steady stream of losses is to be avoided.

Purpose of Bank Records.—Bank records are kept for three purposes. (1) To have a chronological account of all that goes through the bank—a minute history as it were. Inasmuch as a bank must be able to produce proof of all it does, day by day, these running accounts are most important. They are original records. As the historian keeps a record of all that is done in his particular field, and thereafter weaves it into a story, so the bank must keep a history of all that goes on within its organization, so that when put together it makes a complete

record of what happened. (2) To know the exact position of the bank at any time—what it owns and what it owes. It must know exactly what assets it holds and what they are worth, and must know exactly what it owes and to whom (3) It must know from time to time what progress it is making both in respect to its growth, and also in respect to its profits

The first class of records constitutes the bookkeeping system of the bank. The system is brought to a focus and the results are set out in a balance sheet whenever reports are called for or a statement is made up, which justifies the second purpose; and when the books are balanced and an earning sheet is made up, then the profits or losses may be determined. Until profits are known dividends cannot be considered.

Bank Accounting the Same Everywhere.—The principles which govern bank accounting are the same for all banks The general books of record are similar in the facts which they record. The *manner* of their recording may be according to individual taste, but the records must contain the same fundamental information. For instance, certain facts must be known about the securities held by the bank. The manner of recording these facts are different, but the facts are the same One bank will have one arrangement, while another will prefer a different form; but it is merely one man's ideas as against another's.

It would be futile to attempt to describe a set of books for a bank that could be called perfect, or standard, for that system is perfect which works to the end desired, which is accuracy of record and completeness of control. It is immaterial *how* the result is achieved so long as it accomplishes the purpose. Inasmuch as all banks must make reports at stated times, the facts must be accessible, and the bookkeeping system of all banks may be

said to be uniform in the fact that it groups the information to conform to these requirements. Where reports are required weekly, as in clearing house centers, such facts must be ascertained and reported, and such records may be said to be uniform; but otherwise there is a great diversity of mind in bank accounting procedure.

When the New York State Banking Department sends out a call for reports, the same forms are sent to the Corn Exchange Bank with about fifty branches as are sent to the smallest bank under the state jurisdiction. The latter assembles its figures from the books in one banking office, while the former assembles the figures from fifty offices and puts them together on the same identical sheets as are provided for the small bank. The Corn Exchange Bank may have one method of recording its loans, and the small bank another, but the same facts must be set forth and in the same arrangement in the report

Bank examiners, in making their periodical visits have a great opportunity to strengthen the bookkeeping systems of the banks under their supervision, and as a rule suggest such changes as will make for efficiency and proper control. Banks also follow one another in arranging their forms, and this makes for similarity The greatest factor in making bank work uniform has been the machine bookkeeping which is now so common and is quite the same in a large number of banks. Such mechanical devices are adaptable to the smallest bank and to the largest. It is merely a matter of adding units.

Banks are very apt to follow a leader, and once a well-managed bank adopts a system and proves it practical, many others will follow as a matter of course, and the same holds true of many of the incidental features of the bank's operation.

In a work of this kind, a description of the work of a very large bank would not meet a general need, nor

would a description of the work of a small country bank. The author therefore elects to describe the *principles* that underlie the work in the different departments of banking, and what facts should be recorded, rather than attempt to tell exactly how these facts should be set down.

Bank Records.—Banks keep four kinds of records: (*a*) Corporate records; (*b*) financial records; (*c*) statistical records; (*d*) credit records.

Corporate Records.—Inasmuch as a bank is a corporation, it must keep such records as the law and corporate management require. These consist of:

The Stock Book.—This is the stock certificates in bound form with stubs. Each certificate is numbered, and the stub records to whom it was issued, with date, number of shares, and if a transfer, as distinguished from an original issue, the number of the certificate cancelled and the number of shares of the old certificate and from whom transferred. Such certificates are usually signed by two officers, with seal of the bank.

Stock Transfer Book.—It is convenient and often necessary to have a record of all stock transfers set out in debit and credit form, showing the chronological history of the transfer of stock.

At the organization of the bank, the stock transfer book will show: Date of issue, to whom issued, number of shares, and number of certificate. The total must equal the number of shares authorized. Thereafter it will show all *transfers* of stock. One side will record the date of transfer, to whom transferred, number of shares and certificate number. The other side will show: Date, from whom transferred, number of certificate cancelled and number of shares turned in for transfer. The difference between the two sides of the book must always equal the authorized amount of shares

as to number, and a total of the shares as shown by the stubs of the stock book must equal the authorized capitalization. As certificates are turned in for transfer they are cancelled and pasted on the stubs. Thus all stubs without an attached cancelled certificate represent outstanding certificates. The required amount of documentary stamps must be attached to cancelled certificates and cancelled. The required amount of stamps on new shares may be pasted on the stubs as certificates are issued.

Stock Ledger.—This book records the ownership of the bank. Each stockholder has an account. He is credited with the amount of shares held by him, by date of issue, certificate number and number of shares. Certificates turned in are debited in the same manner and the difference represents his stock holdings. From this book the dividend checks are made out, and the total of the various accounts must at all times be the same as the total authorized number of shares.

Minute Book.—The minute book is best kept in loose leaf form, so that the minutes may be typewritten The transcript of the meeting should be complete as to what occurred in the meeting, except the incidental discussion. The record begins with the date of meeting, those present, presentation of reports, resolutions and their fate, old and new business transacted, loans made and loans ratified. This book should contain a record of the bank directorate, when elected and when retired either by death or otherwise. Also the incumbency of offices should here be set forth, in a record by itself, so that the future bank historian may easily obtain a record of the changes in the official staff as occasion requires for historical or obituary purposes. The book should be indexed as to proper names and subjects so that the record may be available as occasion requires.

The stockholders' meetings are important occasions and the data in this respect should be complete and comply with the stock corporation law of the state. The regularity of the election should be easily provable from the record as set forth in the minute book. Committee records are kept in a similar manner, and the index may cover both records, so that the subject

INDEX TO MINUTE BOOKS

COMMERCIAL BANK

Name____________________

Meeting held____________________

Board __________

Committee__________

FORM 29 —Index to minute books

matter may be classified in one place with reference to the source. It frequently happens that the bank officials are uncertain whether a matter was passed upon in committee or in the board. A card index with different colors for each set of records will prove helpful.

Statistical Records.—There are many facts which a bank desires to know about its business which are matters of statistics. These are gathered from the work of the bank and summarized for use in analyzing the business. These are necessary in obtaining accurate information about the bank's progress from time to time, and are useful in making comparisons with previous periods. The statistical records will include:

Classification of expenses.

Classification of income.

Classification of loans.

Summary of the following:

Deposits received each month in various departments.
Amount paid out each month in various departments.
Number of deposits received in various departments
Number of checks paid in various departments.
Safe deposit boxes rented.
New acounts received, and amount of initial deposit.
Accounts closed.

CLOSED ACCOUNT

Name ______________________

Address ______________________

Date closed ______________________

Closed for $ __________

Letter ______________________

Savings
Checking
Safe Deposit Box

Reason ______________________

Card Removed ______________________

Form 30 —Closed account record

The Financial Records.—The financial records are those having to do with the daily work. They include all the books used in the bank, the most important being:

(*a*) The controlling books—general ledger, statement book and journal.

(*b*) Books of account—as follows:
Customers' ledgers.
Savings ledgers.
Christmas club.
Securities ledger.

Collateral loan ledger.
Mortgage ledger.
Liability ledger.
Maturity book.
Notes discounted register.
Certificates of deposit ledger.
Collection register.
Cashier's check register.
Certified check register.
Securities held for client's register.
Securities bought and sold register.
Registered mail book.
Return item books.
Suspense ledger.
Other incidental records used in various departments and discussed under the appropriate heads. These are *records* as distinguished from *books*.

Credit Records.—The records having to do with credit and loans are kept in the credit department, and aside from those kept in the loan and discount departments are:

Credit files, containing borrowers' statements, reports, investigations, credit letters, comparison of statements, etc.[1]

Average balance records.
Average loan records.

Bank Accounting Records.—Bank accounting involves no principles that are not included in the general practice of accounting, and has to do with nothing but money and credit. There are no sales or returns, no merchandise to account for and no discounts to figure (in the commercial term). There are, however, branches of

[1] See under Credit Department.

accounting peculiar to banking, the principal one being amortization of bond premiums and discounts, which is distinctive to financial accounting.

Generally speaking we have three kinds of records as found in the general ledger, namely: (1) Accounts with the property of the bank; (2) accounts with customers' dealing with the bank; (3) nominal accounts, set up to take the place of assets gone out of the bank's possession or liabilities for funds received set up to offset the receipt of funds in the assets.

The General Ledger.—The general ledger is a book of control, to which are carried in bulk or in detail all the activities of the bank. It summarizes and groups all the assets and liabilities. If each account showing a debit balance were to be set up on the left of a page and the credit balances were set up on the right the total of the two should agree, for banks operate on the well-known principle of accounting that *for every debit there must be a credit*, and the whole scheme of bank accounting hinges on this fact.

If a general ledger be examined it will be found to contain an account for every asset and liability of the bank. To these accounts are carried the total each day of all the other books (which represent these accounts in detail). A general summary of bank operations is best obtained by going through this book and ascertaining just what each account represents.

The form of this book is a matter of personal preference. The author favors a loose leaf book with index tabs for every account to be handled. The ruling is: Date, explanation, debit column, credit column, debit balance, credit balance.

The loose leaf form allows the bookkeeper to insert new leaves as necessary, and remove the old to transfer binders, thus making the book elastic and responding

to the bank's varying needs. By removing the used sheets they may be carried to transfer binders under the same heading for two or three years. Thus, profit and loss account for several years will be found consecutively arranged.

The Journal.—Before treating the general ledger in detail it will be well to consider the *journal,* from which the postings are made. This journal is a chronicle of the daily changes in the assets and liabilities of the bank. The beginning for the day is the cash on hand. To this side is carried all receipts from whatever sources they may come. On the other side are listed the outgoing sums and other changes in the status of the bank. Interest received, for instance will be carried on the journal under the proper head, as a liability, while the corresponding entry will be a charge to cash. The payment of checks in cash will be a credit to cash and a charge to amount due depositors. Thus the journal reflects the daily changes in the various accounts, in favor of or against the bank. These changes are then carried to the general ledger and from the latter to the *statement book,* which is a summary of the general ledger.

The journal proves the work of the whole bank for the day as each department proves its own work. The journal in small banks contains the details of many transactions, while in the large banks it deals with totals only. The journal clerk must constantly work by the rule that for every credit there must be a debit and vice versa, and if he does so he will have no difficulty in effecting his proof. Many banks have journal tickets arranged to show these counterbalancing entries.

The Statement Book.—The statement book is a summation of all the accounts in the general ledger. It contains on the debit side all asset accounts and on the credit

side all liability accounts. When brought to a footing the two must agree.

These accounts are usually printed in the statement book, the amounts only being entered in ink. When the daily statement is made up it shows the status of the bank as at the close of business. The value of this book is fourfold:

(*A*) It shows the bookkeeping of the bank to be in balance.

(*B*) It shows the position of the bank in regard to all important items.

(*C*) It shows the reserve ratio, and from this the bank may decide as to its loan policy for the day.

(*D*) In comparison with similar figures of former years it shows the bank's progress in respect to each item on the statement.

The accounts as set up on the statement book should follow the same order as on the general ledger, or vice versa, thus making posting from the journal to the ledger a consecutive process. We will now turn to the general ledger and obtain a concise idea of each account shown therein and at the same time an analysis of the assets and liabilities. We shall take first the real asset accounts, following these with the nominal accounts for both debit and credit side.

Cash on Hand.—This account represents the cash holdings of the bank. The cash may be divided into gold, silver and subsidiary coin and currency. The latter may be still further divided into the various kinds of currency in circulation. Petty cash and cash items are indicated separately.

Exchanges for Clearing House.—This item consists of checks ready for presentation at the clearing house on

the following morning As a rule such checks are regarded as equivalent to cash. Of the same tenor are other checks on local banks to be collected by messenger. The total of the foregoing items is generally spoken of as "cash and exchanges."

To the cash account are charged all receipts of money and all payments are credited, these debits and credits being automatically made by entry of the amount on the opposite side of the journal sheet. In other words cash is automatically charged with every credit that arises from the receipt of cash, and all payments result in credits to cash, so that the journalizing is automatic The cash on hand and checks held for collection must agree with this amount.

Securities Account.—All purchases of securities are charged to securities account in the amount paid for them, not including the accrued interest which is a charge against interest received account. Inasmuch as the interest paid out on such purchases will be returned to the bank at the next interest date, the author prefers to charge interest accrued paid to interest *received* account. This practice reserves the *interest paid account* for actual interest payments to customers of the bank, and does not mingle items that are a direct charge against earnings with amounts that will subsequently be returned.

The total found on securities account must be the same as the sum of all the individual items found in the *Securities Ledger* under "book value" The general ledger is therefore a book of control over the securities ledger, one recording the details of all securities bought and sold and the other mere debits and credits representing the same transactions.

The journal entry for a $5,000 block of bonds bought at 90 with accrued interest of $95 76 would be

Debit:	Securities account, New York Central 6's, 1950	$4,500	
	Interest received	95 76	
Credit	(Bonds paid by check on Irving National Bank)		
	Irving National Bank Check No 18762		$4,595 76

Securities account may be divided into several classifications in order to record the amount of each class held as investment. Such a division would be:

Government bonds.
Municipal bonds.
Railroad bonds.
Public utility bonds
Industrial bonds.

(The classification could be made in either the general ledger or the securities book.)

Following the securities account in the general ledger there should be a page for each block of bonds, recording the name of the security, date purchased, amount at par and book value. This is merely a debit and credit record, for the purpose of acting as a secondary control over the general ledger securities account and as a check on the bond book. It may however be dispensed with and all the bond records kept in the securities ledger except the general control.

The Securities Book.—The securities ledger should contain a complete description of all securities held by the bank as investments, together with the principal and interest records mentioned below. The following details should be provided for in any arrangement that will be practical and workable·

Name of security in full.
When issued.
When purchased.
Callable feature of bond.
Cost.

Interest rate.
Of whom purchased.
Net income basis.
Maturity.
Interest periods.
Amount of each bond.
Numbers.
Par value.
Market value with date.
Book value.
Amortization figures.
When interest due.
Amount due.
When paid.
Interest on the block for one day.

Provision should be made for checking the securities from time to time to record the fact that they were in the bank at the time indicated. Provision may also be made for recording when and where securities are pledged.

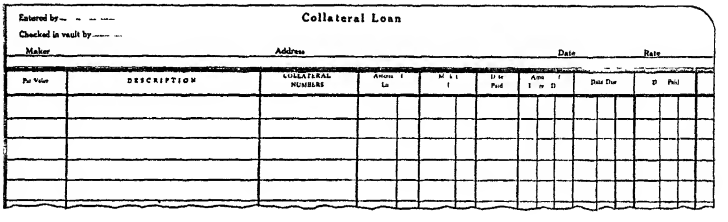
Collateral Loans.—To the collateral loans account is carried each day, the amount loaned on collateral. If the bank classifies the various kinds of collateral loans, there will be an account for each class. For present purposes we treat all collateral loans as in the same class, namely, payable on demand. The individual items will be found in the *Collateral Loan Ledger* with details, the sum of which must equal the amount here shown. The loans made each day are entered in a loan record and carried to the journal for the day in one amount; and from the journal to the ledger. Loans paid are credited through the same process from the loans paid book.

Assuming the loan is made to a customer of the bank, the journal entry for a loan of this character would be:

Debit Collateral Loans	$10,000	
Credit Deposits		$10,000

Collateral Loan Ledger.—The collateral loan ledger holds the collateral loans. It should be complete in itself and contain:

Name of borrower and address.
Par value of collateral.
Date of loan.
Collateral with full description as to name.
Market value.
Amount loaned.
Rate of interest.
Number of bonds or stock certificates.
When payable.
Amount of interest.
When due.
When paid



FORM 31.—Collateral loan ledger

The total of the "amount loaned" columns must agree with the collateral loan account in the general ledger.

Collateral loans may be divided into
Street loans (made in open market).
Customers collateral loans.
Warehouse loans.
Loans on arrival drafts

Loans on bills of lading.
Loans on automobiles.
Loans on textiles, etc

Discounts —The discounts account represents all loans in the form of paper discounted for customers of the bank. This items may be divided into as many classes as the bank elects, as single-name paper, two-name paper, time collaterals, customers' paper, purchased paper, etc.

This account controls the notes discounted themselves, and also the amount shown by the liability book. If, for instance the bank has discounts of $1,000,000, there must be in the files notes aggregating the same sum. And if these notes have been listed in a liability book, showing how much each borrower has received, the sum of the liability book must prove with the general ledger account The proofs of these two—the notes and the liability book—are taken at frequent intervals and must agree with the ledger account. The daily postings are made from the notes discounted book, in total, first to the journal sheet and then to the ledger.

The journal entry for a note discounted, assuming the proceeds are credited to the customer's account will be:

Debit Notes discounted		$1,000	
Credit	Customer		$984 80
	Discount (or unearned discount)		15 00
	Revenue stamps		0 20

Due from Banks —One of the most active accounts on the general ledger is the "due from banks." There will be an account with each correspondent bank. To this account are charged all items sent to the bank, and to it are credited all items received from it and all drafts drawn on it The letters sent to the bank form the charge tickets, and are carried first to the journal and then to the ledger. The checks drawn on the bank

are totaled each day from the stubs or the check register, and put through in one amount.

Where the connection is not active and only occasional transactions occur, one account will suffice for such banks, through which the entries are made from time to time. Some banks designate this as "collection account." Where certain banks are legal depositories and others are not, they are listed separately on the statement so as to show the amount allowable as reserve. These accounts are reconciled monthly. The amount due from banks plus the cash on hand forms the bank's quickest asset, the first line of defense against the demands of the depositors.

Bank Building.—The amount at which the bank building is carried is for the board of directors to determine. If the building were new, the cost of construction would be charged against this account until completion, giving the various items as bills were rendered and paid. Thereafter the board will decide if the land and building is to be carried at cost or some other figure. It is the general policy to charge off from time to time such amounts as the board may decide until it reaches a figure satisfactory to the management. After this has been done, the amount will remain stationary, as a fixed asset.

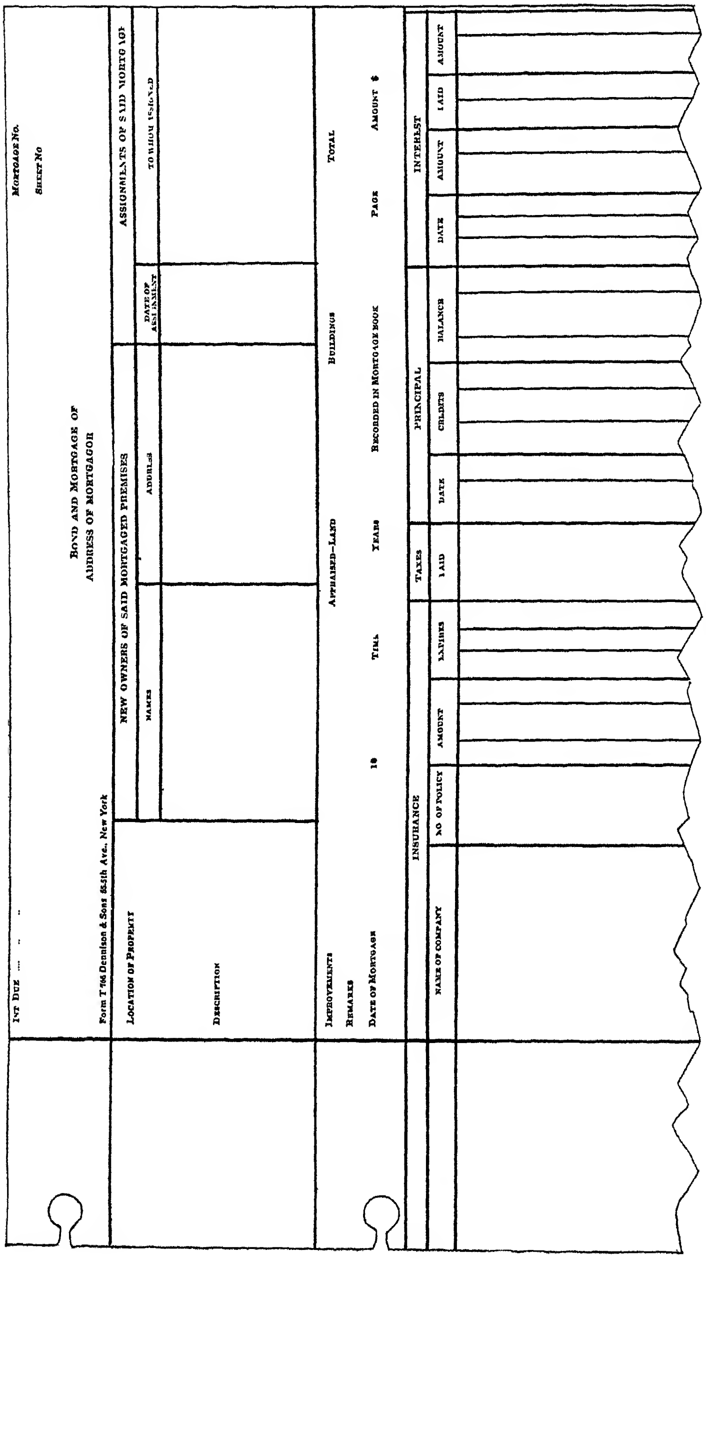
The cost of operation, taxes, heat and light, repairs, janitor service, etc., are charges against *building expense account,* and do not affect the bank building account. If an addition or alteration were afterward made, it would be charged to the bank building account, as a capital charge.

Where the bank rents portions of its building, a bank building rent account should be carried, to which are credited the rents received and to which all costs of operation are charged, thus showing the net income

This may be a separate book or a separate section of the general ledger, for information purposes, the items being taken from expense, rent, tax accounts, etc.

As a general rule of law, banks are not allowed to invest in real estate except for banking purposes. The term "banking purposes" covers many things. Under the law a bank may erect a bank building, and from the unused portion may derive an income in the form of rent. Under this concession banks everywhere erect office buildings, occupying a portion and renting the remainder. The investment in this respect is optional with the board, but as a matter of precaution, the supervising authorities should be consulted and their consent obtained, if the investment is to be substantial. Otherwise the management might be accused of extravagance and bad judgment. For example, the erection of a bank building costing $100,000 by a bank whose capital was but $50,000, and whose deposits were less than a million, would reflect bad judgment. The capital is therefore solely represented by the banking structure and it is unethical, to say the least, for a bank to invest the depositor's money in a banking structure.

Mortgage Loans.—The mortgage loan account represents the amount due from the various borrowers on mortgage security. The details are found in the *mortgage ledger,* and the sum of the amounts still unpaid from the various borrowers must equal the amount shown on the general ledger. Such loans are not made with the same frequency as discounts or collateral loans and this will not, in the average bank, be so active as the other loan accounts. In putting through a mortgage loan, most banks prefer to draw a cashier's check for the amount as evidence of the payment, and with this assumption in mind, the journal entry will be:



Form 32 —Mortgage ledger.

Debit	Mortgage loans	$5,000	
	Credit Cashier's checks		$5,000.

Mortgage Loan Ledger.—The mortgage loan register contains full details of each mortgage loan made by the bank. These details are.

Name and address of borrower.

Location of property, with diagram of plot and its location

COMMERCIAL BANK

No . .. 19

Interest in the amount of $.... ..on your mortgage loan of $

will be due and payable at this office on .. .. .19

Yours very truly.

COMMERCIAL BANK

N B—At the time of payment of interest please produce all receipts for Water Rents, Taxes or Assessments which have become due on this property since last payment of interest

FORM 33—Interest notice

Size of property and character of premises.

Date of mortgage

Time to run.

Time of record.

Changes in ownership of property.

Appraised value.

Record of insurance carried.

Amount loaned

Payments received.

Record of interest charges and payments.

Record of taxes paid. (Obtained by requiring borrowers to submit their tax bills.)

Other Real Estate Owned.—While a bank may not lawfully own real estate except for banking purposes, it may take real estate for debts previously contracted. In many cases borrowers are unable to pay their obligations and turn over to the bank real estate in settlement. In other cases banks take mortgages as security for debts, previously or currently contracted, and find it necessary to foreclose their liens and buy in the property. In such cases it is held as "other real estate owned" to distinguish from the bank building. Generally speaking such property must be disposed of within five years. If not sold within that time, the consent of the supervising authorities must be obtained to hold for a longer period. (The time limit is standarized in national banks to five years, but may vary in the different states.)

The amount shown in this account represents real estate so owned. There should follow this account, which includes all property so held, a separate account for each piece of property. The individual account will show the purchase price, or cost, together with the income received, taxes, insurance, repairs, etc., paid,[1] so that the net earning power of each piece of property may be known. These latter accounts are for information purposes only and the balances do not enter into any proof of the ledger when carried to the statement book. The controlling account only is entered in the statement book

Furniture and Fixtures.—Furniture and fixture account holds the cost of equipment, desks, mechanical devices, typewriting and adding machines, safe deposit boxes, safes, etc. which constitute the bank's equipment. Some banks make it a practice to charge such costs to expense account; but broadly speaking they are not expense items, but deferred charges to expense of

[1] These items are carried in the rent, tax, expense, insurance accounts, etc.

operation. The cost of an adding machine that will last for ten years should not be considered as an expense in the year purchased; it should be charged to "Equipment Account" and charged off in yearly or half-yearly amounts until it is eliminated from the assets entirely How fast to make these charges is for the board to determine; but inasmuch as the income tax regulations do not permit a bank to consider such costs as chargeable against any one year, the pro-rating of the cost is much the better way, and from an accounting standpoint correct. In organizing new banks this item is heavy, and represents the investment in the banking office. The better way is to charge part to the contributed expense fund and part to equipment account; but at any rate, to charge off this item as fast as profits warrant until it stands at a reasonable sum.

Suspense Account.—A "suspense item" is an instrument which has been determined slow, doubtful or bad The process, down hill, as it were, is· First it is carried as past due until renewals are impossible or undesirable, then it is placed in the hands of the bank's attorney or legal department for collection; this failing, it is charged off and put into suspense account, usually at a nominal sum to keep the account alive. In order to get past due and doubtful items out of the work they are placed in the suspense class, there to be given such treatment as the case requires.

Suspense Ledger.—The suspense ledger will contain all items charged off the books. The record should be in great detail, inasmuch as litigation often attends such items and the exact status of each should be known at all times. The accounts will run numerically with index of names. The account will show the original amount with any payments, charges, etc. A brief history of each item will follow, such as: "Charged off

by order of board" with date; "given to attorney for collection", "judgment rendered and entered," etc. thus detailing all the steps taken to collect. If judgment has been obtained the papers should be attached to the instrument. If judgment is returned from the sheriff's office unsatisfied, it will be noted and the account will remain in status quo until recovery is made. Many such items are subsequently recovered and all such recoveries will constitute a credit to undivided profits account and be credited against the account in suspense ledger Many banks carry all items in suspense account at $1 each. In no other way can charge offs be systematically followed up Many banks have made a serious mistake in abandoning items charged off as hopeless of recovery A well-managed suspense account will justify itself in many ways, not the least of which is subsequent recovery of losses taken. Time works wonders in this respect and substantial additions are made to profit and loss account years after the loss has been taken.

Nominal Asset Accounts. *Interest Paid.*—One of the largest charges against the income of a bank is interest paid. This includes the interest paid on checking accounts, savings accounts, certificates of deposit, etc. The interest on checking accounts is figured monthly or quarterly, while interest on savings accounts is figured semi-annually as a rule. Interest on certificates of deposit is paid when the certificate matures, or at periodical times. Each month after the interest has been computed on the daily balances, credit tickets are made out for the various accounts and the total of these constitutes a charge to interest paid account. The daily payments as made are likewise charged When the interest on savings accounts has been computed at the end of the period, and the total ascertained, the

interest paid account is charged with the amount The various accounts are credited from the interest computation sheets and entered as a credit to deposits, thus·

DEBIT *Interest paid* (savings accounts)	$24,786 98	
CREDIT *Savings Department*		$24,786 98

Taxes Paid—Banks pay taxes of various kinds, the principal forms being, real estate taxes, capital stock tax, profits tax, tax on circulation (national banks only)

While taxes are an expense, they are generally set up separately in the statement book and general ledger To this account are charged the taxes as paid, the amounts paid on real estate being carried to the various pieces of property as memorandum charges (The apportioning of taxes by setting up a reserve for taxes will be found under *taxes accrued*, subsequently.)

The taxes paid by national banks in New York State, which typifies the general practice in this regard, are as follows·

(*a*) *Tax on Circulation*—This form of taxation applies *only to national banks* on account of the tax of 10 per cent imposed by the National Banking Act upon state bank note issues The taxes imposed by the government upon note issues are as follows·

> Upon the average amount of notes issued and outstanding and secured by government bonds bearing 2 per cent interest one-quarter of one per cent semi-anually Upon the average amount issued and outstanding and secured by other government issues one half of one per cent semi-annually

Within ten days of the first of January and July national banks make a return to the government of the average amount of their notes outstanding secured by the various issues of bonds for the preceding six months and are assessed accordingly.

(*b*) *Tax upon Capital Stock.*[1]—National banks, being subject to the Federal government cannot, as such, be taxed by the states for anything except real estate owned by them and upon their shares of stock. The latter tax is in reality levied against the owners of the stock but is paid by the bank. This is based upon the theory that these shares are the personal property of the stockholders. The shares are taxable in the district where the bank is located and are not taxable as of the residence of the owner. The method used in New York illustrates this form of taxation. All banks in the state, including national banks, are required to make a report as of May 1 of their stockholders and the number of shares held by each, together with the capital, surplus and undivided profits of the bank on the same date. A list of stockholders with their proportionate share of the bank's capital holdings is sent back to the bank, from the tax office, with amount assessed against each shareholder. The bank in substance becomes the agent to collect this tax and remit to the tax authorities. The tax rate is one per cent of the value of the stock as found by adding the capital, surplus and profits together. This tax is payable on or before December 31, and while it is legally collectible from the stockholders, as a matter of practice it is paid by the bank as a charge against earnings. The theory is that their dividends would be increased if the tax were not so paid, sufficiently to compensate them for this tax, which upon being paid into the public fund would place them in the same posi-

[1] A test case has recently been decided in New York to determine the taxibility of national bank shares under the New York laws It is held in this case that shares of national banks are no longer taxable in New York The decision does not affect state banks The matter will undoubtedly be carried to the courts of last resort, but at the present writing (October, 1923) national banks in New York do not pay the tax above referred to.

tion as if the bank paid the tax for them and held it out of the dividend. In other words bank dividends are paid tax free.

(c) *Real Estate Taxes* —These taxes are levied upon real estate held by the bank and are payable exactly as taxes against any individual's property would be

(d) *Capital Stock Tax.*—Domestic corporations in the United States are subject to a franchise tax amounting to one per cent of the average fair value of the capital stock for each full $1,000, for the taxable year preceding, allowing a deduction of $5,000. These values are determined in various ways as set up in blanks furnished by the government for report purposes

(e) *Income Taxes.*—Under the Income Tax Laws banks are taxable on their income as determined in conformity with the law. These taxes and their method of computation can best be understood by a study of the income tax law which is beside the scope of this work. The method of working out these taxes is set out in schedules furnished by the government and must be closely and completely followed, and each deduction be clearly provable as allowable from the income. Generally speaking the process is as follows: From the gross income deduct·

Ordinary expenses.
Losses not covered by insurance.
Interest paid on deposits.
Interest received from tax exempt securities
Certain taxes.
Depreciation.

This leaves the net income taxable according to law

(f) *Stamp Taxes.*—These include stamps on stock certificates, promissory notes, drafts, deeds, powers of attorney, proxies, loan agreements, etc. These taxes are set forth in the schedules in the income tax laws, which must be familiar to the note teller or general

bookkeeper. The stamps are attached to the instrument and should be cancelled by the maker of the instrument, but as a matter of practice they are cancelled at the time the instrument is discounted usually by rubber stamp. In most cases the stamp tax is paid by the customer.

Expense.—The expenses of a bank are heavy and expense account is an active one To it are carried all operating charges such as salaries, stationery, telephone and telegraph, legal expenses, light and heat, expressage, and miscellaneous items. These are not classified in the general ledger, but are carried as items day by day, the classification being made in the *expense classification book,* for statistical purposes

Expense Classification Book.—It is essential in operating any business to know the details of cost of operation. In banking these expenses consist of two divisions· (*a*) Expenses connected with the bank building (particularly where portions are rented) and (*b*) general expenses of the bank. In order to arrive at a correct basis for fixing rents, and to ascertain the net income from the building, the charges against the building must be kept separate and set against the rents. Two expense accounts would be maintained under such conditions, and the various items carried to the respective accounts. Under the bank building, the expenses would be classified into Light and power, insurance, janitor service, repairs, taxes, supplies of all kinds, classified into engineer's supplies, superintendent's supplies, etc. The classification of the bank's operating expenses will be· Salaries, stationery, insurance, advertising, telephone and telegraph, messenger's expenses, directors fees, expressage, postage, lunches, traveling expenses, miscellaneous, etc The expenses may be carried to expense account and classified afterward, or entered in the classification book in detail and in the general ledger in bulk.

Payment of Expenses.—As the bills against the bank come in they are filed until the time for payment arrives. Where discounts are given, the invoices should be paid before the expiration of the discount period. Other bills should be paid at stated times during the month Each invoice is checked against the receipt of the goods by the receiving clerk. In the larger banks all supplies are purchased upon requisition by the proper officers One part goes to the seller, one to the receiving clerk to be checked against delivery and one to the auditor As the invoices are received they are checked against the requisition and the delivery, and payment authorized When the invoices are properly authenticated cashier's checks are drawn for the amounts. Some banks use the voucher system, entering the details of the purchase on the voucher stub, and sending out a voucher check in payment. From the stubs the classification clerk enters the amount in its respective place in the bank's classification book.

Overdrafts.—The overdrawn account is the bane of the banking business. An overdraft is essentially an unsecured loan without interest, unless the bank has a rule that interest shall be charged on overdrafts—and many banks do so Whether an account is overdrawn or not cannot be told until all debits and credits have been posted; and where the posting of the checks is done before the posting of the credits and deposits, the result of the day's work cannot be known until all postings are made Upon the first posting in the morning an account may be overdrawn, while it would be amply protected during the day. Banks do not however, encourage such accounts as work on so close a margin. Many overdrafts are the result of error on the part of the customer, while many are the result of running the account close to the danger line.

In many institutions the task of passing upon overdrafts is assigned to a junior officer, who determines whether they shall be allowed, or what steps to take to cover. In the fear of offending a good customer leniency is exercised and checks are sent back only when in good judgment such a course is necessary. As soon as the bookkeeper discovers that an overdraft exists, an examination is made in various parts of the bank to ascertain if there be credits to cover it

COMMERCIAL BANK

192

According to our books, your account is overdrawn $

Kindly forward deposit covering this overdraft, also send in your pass-book so that same can be reconciled

Yours very truly,

COMMERCIAL BANK

Mr

Form 34—Overdraft notice

These may be deposits received but not credited, notes discounted and not yet passed for credit, collections not yet credited, etc. Only when the overdraft is uncovered is the executive consulted and he determines whether enough checks shall be returned to eliminate the overage. In a large bank, the bookkeeper would make out an overdraft slip and send to the various departments, asking what they are holding to cover When this comes back to him he knows his own position

Inasmuch as clearing house items must be paid by a certain hour or returned, the bank must make its choice by that time or lose its right to return the check as unpaid

to the clearing house. Where overdrafts are allowed the customer is notified by mail or 'phone. A record of habitual overdrawing is quite disastrous to one's credit

Technical overdrafts may be created by paying against uncollected funds, which would not show up as an overdraft on the books and yet would be an advance of the bank's money against uncollected checks.

Overdrafts are not as a rule carried in the statement book, but are deducted from the balance proofs in making up the proof with the general ledger. In taking off statements for reports to the authorities, overdrafts are listed as an asset, which they properly are, and to offset this increase in asset values the deposits are increased by the same amount.

Teller's Differences.—All tellers naturally make mistakes In the multitude of transactions, each with the possibility of error, mistakes must necessarily enter into the work. Some of these are found upon checking back the work and some are never reconciled. After an error has failed of correction after due effort, it is charged or credited as the case may be to *tellers' difference account* The amount in this account shows the net gain or loss at the counter. Other errors are adjusted through profit and loss or adjustment account; but no error should constitute a charge or a credit until diligent effort has been made to locate the mistake. Where errors are too lightly treated the clerks are apt to become careless; but if they are required to search for their errors until every reasonable effort has failed of result, they are likely to give due thought to careless and indifferent work.

Accrued Interest—The interest which a bank earns comes from various sources and at various times. The interest on loans is collected at stated times, monthly, quarterly, etc. The interest on mortgages as a rule is

collected every six months. Interest on bonds matures semi-annually. A bank having a large list of bonds will have interest falling due every month. It follows that at no time has the bank received all it is entitled to, inasmuch as the interest does not fall due at any one time.

In order to know the status of the bank at any given time, the amount of interest due but uncollectible at that time must be taken into consideration.

Banks that are highly organized keep reasonably accurate account of the daily accruals and charge the same to *accrued interest* each day. As payments are made they are credited against the charges already made. These computations are not difficult to make once a starting point is obtained. If, for instance, the bank holds $600,000 in mortgages at 6 per cent the accrued interest will be $100 a day. Any additions to the mortgages will increase the amount and any deductions will reduce it. Therefore the accrued interest account is charged $100 for this item daily. If there are $500,000 of bonds yielding 4 per cent the daily accrual will be $55.55.

Most of the smaller banks do not go into such matters to the extent that the larger banks find it advisable to do, and only accrue their interest when reports are called for. At such times computations must be made for each class of assets, which at best consume considerable time. The most helpful method that has come to the attention of the author is to have the amount of interest for one day computed for each block of bonds. The amount of accrued interest on the block will be this amount multiplied by the number of days between the last payment of interest and the date of the report Mortgages may be figured the same way, unless the interest falls due on uniform dates, as it should, when the accrued interest on all mortgages will be ascertained by

computing the interest on the total amount at the various rates from the last interest day to date. For this purpose the mortgages must be segregated as to interest rates.

The same idea may be used in computing interest on bonds, by taking all the January and July maturities, for example, and finding the amount of interest due on each class according to income rate from January or July to the date of the report. Allowances must of course be made for mortgages made since the last interest day and bonds recently purchased.

Demand loans, having interest due at stated periods may be computed by segregating the various rates and figuring the interest on each class from the last interest date to date of report, making allowances for recently made loans.

Customers' Liability on Account of Acceptances.—Within recent years there has appeared two items on banks statements not theretofore carried, namely On the asset side appears "Due from customers on account of acceptances," and as a liability "Liability on account of acceptances made." These are usually in the same amounts. The liability represents the bank's obligation incurred by reason of acceptances made for customers, which constitutes a direct liability on the part of the bank to the holder of the acceptance, but at the same time the bank expects to receive funds from the parties for whom the acceptances were made in time to honor the same The obligation to pay the bank is therefore a direct asset, but the obligation to pay the holder a contingent liability. The bank may cover itself in making an acceptance by a loan agreement, or other instrument, upon which it could sue if necessary, and therefore holds the book entry for these obligations in exactly the same amount as it has incurred with the public.

Liability Accounts. *Capital Stock Account.*—This account must equal the paid in capital of the bank, at par value. In a new bank it would increase as fast as the subscriptions were paid, and eventually reach the authorized amount. It does not fluctuate and changes only at long intervals when the capital is increased and in rare cases where it is reduced The amount shown on the Stock Ledger as standing in the names of the various stockholders must in total equal the amount here shown.

Surplus Account.—The law requires and good banking demands that the bank set up a fund for the protection of depositors, aside from the capital stock and stockholders' liability heretofore discussed. As a rule of law, dividends may not be declared unless part of the earnings are set aside for surplus; but after the surplus has reached 20 per cent of the capital, the compulsory additions to surplus are no longer required.

New banks generally aim to start with a surplus fund of at least 20 per cent of their capital, and sell their stock on such a basis as will provide a surplus fund at the beginning. Thereafter additions are made to the surplus out of profits as the board of directors may determine. It is not advisable to build up this fund too fast, lest losses again deplete it; the better way is to carry profits in *profit and loss account,* or *undivided profits account,* until it is large enough to warrant a division into surplus account. A growing surplus reflects able management and substantial earnings. Some banks have in the course of time built up surplus until it is several times larger than the capital, making the stock very valuable.

Assuming that the stock of a new bank is offered at $140 per share, part going to surplus, part to capital and part to undivided profits as an expense fund, the journal entry will be:

Debit Cash		$140	
Credit	Capital stock		$100
	Surplus		25
	Profit and Loss		15

Undivided Profits Account (*Profit and Loss*).—This account holds the undivided earnings of the bank. It is the clearing house through which the various other accounts are closed out when the books are closed at the end of a period. To this account are carried unusual profits and such other charges as are not properly chargeable to such accounts as expense, interest, taxes, etc. The profit on a sale of bonds, for instance, would be carried to this account. An adjustment with a customer will be charged to this fund.

Banks frequently have what is called "charge offs." These are losses that have been ascertained to exist and must be charged off the books. These arise principally from uncollectible loans, and such other losses as are deemed by the board to be beyond recovery. They are charged against this fund.

The dividends are charged against this fund, and any surplus shown in this account increases the book value of the stock, inasmuch as it constitutes an undivided interest in the profits that in the last analysis belongs to the stockholders.

The *book value* of the stock of a bank is determined by adding the capital, surplus and undivided profits together and dividing by the number of shares.

Thus we have:

Capital	$100,000	
Surplus	100,000	
Profits	50,000	$250,000 − 1,000 (shares) = $250

The book value is $250 a share.

In closing a set of books the following entries will be made to undivided profits account:

Debits
- Expense account
- Interest paid account
- Taxes paid account
- Other debit accounts

Credits
- Interest received account
- Rent account
- Exchange account
- Commission account
- Other credit balances

The net increase or decrease reflects the net *receipts* for the period as distinguished from *net earnings*. The latter must take cognizance of accrued interest, interest accrued and unearned discount.

Deposits.—The deposits of a bank are its principal liability, and this fund in connection with the capital, surplus and undivided profits constitutes the bank's investible monies out of which it makes its profits These are usually classified, and are more or less uniform in all banks in the same jurisdiction. These classifications are:

1. *Checking Deposits.*—These are accounts subject to check, and may be classified into as many subdivisions of the alphabet as the bank may desire. They may also be classified into active and inactive, the former being those on which frequent and numerous checks are drawn, while the latter are those of less active nature. The division in which an account belongs may not be known until it has been on the books for some time; although any account with a business house should be active, while those of individuals will be less so.

There will be a ledger account with each group. To this is carried each day the total debits and credits on the group, and the ledger balances of each group in total must agree with this total.

2. *Due to Banks.*—All banks have accounts with other banks, and where the balances are against itself, as is the

case in the larger banks dealing with country banks, this will be a liability. In many banks these accounts are numerous enough to have a *bank ledger,* in which all bank accounts are carried, to keep them segregated from the other accounts.

3 *Savings Accounts.*—One of the developments in banking during the past quarter century has been the savings department, now found in practically all banks of discount. In substance they are savings banks operated as a department of the bank of discount Their method of receiving and paying money is identically the same as obtains in savings banks. In some states these deposits are segregated and invested according to specific laws in stipulated securities, while in others they become part of the general deposit liabilities and the deposited funds are invested in the same manner as other deposits.

The general ledger controls this department. To the account which holds these deposits are carried the deposits and drafts for each day in total, as received from the savings tellers. The total of the card ledgers (now the common method of handling savings accounts) must agree with this total. (See Savings Department.)

4. *Public Deposits* (Preferred). (*A*) *Deposits of the United States* —A great many banks hold deposits of the government, being receipts from various taxes, customs, etc. They are reported separately and carried in separate accounts. They are preferred in that they are secured by government bonds lodged with the government as security for their payment. The Federal reserve banks are now holding most of the public monies and the distribution of government money among banks is no longer the general practice

(*B*) *Deposits of Savings Banks and Building and Loan Associations* (Preferred).—In some states, such as

New York, the deposits of savings banks and building and loan associations are preferred by law. There is no security given for their payment, but they are made a first claim upon all the assets of the depositary bank. A distinction should be made between *preferred* deposits and *secured* deposits. In the former case they are secured by the law which makes them a prior claim, and in the latter by the lodgement of specific security or by surety bonds issued by the surety companies. Thus in one instance, the monies of the county are secured by surety bonds and no pledge of securities can be made against such deposits. Deposits of the State of New York may be secured either by state bonds or by surety bonds.

Where deposits are secured by a deposit of bonds, the bonds would be sold to reimburse the public treasury, in the event of failure on the part of the bank, while in the case of preferred deposits, they are automatically a first lien upon all the assets of the bank. A savings bank does not assume any risk in making its deposits with a bank of discount where such preference exists; but in New York State such deposits are preferred only in state banks and trust companies. National banks can make no preferences of this kind.

(*C*) *State Deposits.*—The various states have large sums of public monies which are kept in the banks, usually within the state. These deposits in the aggregate are heavy, representing the tax receipts from various sources, awaiting expenditure. These deposits are eagerly sought after by the banks, inasmuch as they are large and in many cases steady. The State of New York has millions on deposit with the banks and practically all banks in the state have some portion of the state money. These are generally secured by a deposit of state bonds with the state officials, or surety bonds issued

by surety companies. Such deposits are usually reported separately in the published statements.

(*D*) *Postal Savings Deposits.*—These are the deposits of the local post office, representing the receipts from the postal savings bank operated through the post office. Before a bank may receive such deposits it must lodge with the Postal Savings Commissioners in Washington certain bonds as specified in the Postal Savings Act. Upon so doing the bank may receive from the local post office the postal savings deposits up to a stated percentage of the value of the bonds so deposited. Therefore before a bank can qualify as a postal savings depositary it must purchase, if it does not already hold, certain securities, and send them to Washington, to be held as security for the repayment of these postal monies.

(*E*) *Other Public Monies.*—These consist of deposits of municipalities, counties, villages, school districts, etc. made by public officials and represent local monies as distinguished from state deposits. They are usually deposited in local banks within the confines of the county or city. They are not generally secured by bonds, but are often insured by surety bonds.

Certificates of Deposit.—Many banks issue certificates of deposit for money left on deposit for short or long time periods. These deposits are payable on demand or at a stated time and usually draw interest at a stated rate. A certificate of deposit is an elastic instrument, through which a bank may accommodate the customer who desires interest on deposits that are not likely to remain until the close of interest periods in the savings department. Such deposits are often special or *specific deposits*, for special purposes. For instance, a customer desires to leave a sum of money on deposit as security for the payment of rent on a lease. The amount is to go to the landlord in case of default in the terms of the lease, but

upon completion of the lease the amount is to constitute the last month's rent. A certificate of deposit is ideal in such a matter, and would be issued payable to the landlord "upon compliance with the terms of lease 'Jones to Smith' on file" It will draw interest at the stated rate from time of deposit until time of withdrawal, and forms an excellent method of handling such a matter. A savings account does not fit into such a transaction so well, for such deposits should be standardized, while the certificate of deposit can be made to conform to a great many business contracts where a deposit of money is involved.

Certificate of Deposit Book.—Certificates of deposit are issued from a *certificate of deposit book* which contains the certificates in numerical sequence. They may be divided into demand and time certificates if desired in the certificate of deposit ledger, which has an account for each certificate issued. The character of the certificate is recorded on the stub, with date, amount, to whom payable, by whom obtained, when payable and interest rate. From this record they are entered into the certificate of deposit ledger. Interest is credited in the ledger account at stated times, or at the maturity of the certificate. The sum of these balances must agree with the general ledger and the certificates outstanding as shown by the stubs must agree with the general ledger also. As certificates are redeemed they may be pasted on the stub, or the stub may be marked "paid" and the certificate filed away.

Certificate of Deposit Ledger.—Certificates of deposit are entered in a certificate of deposit ledger, the number of the account corresponding with the number of the certificate. An index of names will of course be kept to locate any name. The customer is credited with the amount under date of issue, part payments charged as

paid, and interest credited at stated times. The summation of the ledger accounts will agree with the general ledger account "certificates of deposit." Where time and demand certificates are issued, they may be classified into different ledger records.

Inasmuch as under the Federal Reserve Act a larger reserve must be carried against demand certificates than on time certificates, thirty days before maturity a time certificate is taken out of the time certificates and carried to the demand certificates for reserve computations. In small banks it is sufficient to treat all certificates as demand, the reserve being of no material consequence. A bank working so close to its reserve is in an unhealthy position.

Where one ledger is used the certificates may be classified on a control sheet, shifting the items according to the above suggestion for reserve purposes.

Certified Checks.—A certified check is in substance a sum set aside out of a depositor's account and held for the payment of the check so certified. It is an obligation of the bank, represented by a specific instrument. The certified check account in total will prove with the certification book in that the amount shown in the ledger must equal the amount of outstanding certified checks shown in the certification book as still outstanding.

Certified Check Register.—The *certified check register* records all checks certified. When a check is offered for certification, it is examined for the same points that a check offered for cashing would be. A charge ticket is then made out, which constitutes the charge against the depositor's account. This is put through the work in the same manner as the check itself would be and is marked on the ledger—"CC" meaning certified check. The ticket is filed with the vouchers. The entries are then made in

the certified check register as follows: Date of check, maker, payee, amount, number of check and number of certification. It is initialed by the officer authorizing the certification and stamped and signed. When it is finally paid the amount is so marked alongside the proper line as "paid" with date and the check goes back to the customer, either with the ticket or without, depending upon whether or not the book has been balanced or statement rendered while the check was still outstanding The journal entry for a certification will be·

Debit—customer
Credit—certified checks

A proof is obtained by taking the unpaid checks outstanding in total, which must agree with the general ledger control account.

Cashier's Checks.—Cashier's checks are issued for many purposes, such as paying current expenses, paying notes and drafts collected, and in fact any payment which the bank may make by its own check on itself, as distinguished from payment by draft on its correspondent. The reason for using this instrument will be discussed elsewhere and throughout the text. The amount outstanding is shown in this account, and is in agreement with the uncancelled checks as shown on the *Cashier's Check Register*.

Cashier's Check Register.—The cashier's check takes on two forms: (*a*) Checks on depositary banks. These are drawn in settlements with other banks, making remittances of various kinds and apply more particularly to the country banks having city correspondents (*b*) Checks on the bank itself. These are used in all banks. In the country banks they are drawn in order to make certain payments and at the same time avoid drawing down the bank's balance with its correspondent. In the city banks they are used largely because the bank

has no correspondent except the Federal reserve bank with which it maintains balances used in making settlements. It clears its cashier's checks with its regular clearings, thus expediting their handling. In country banks the use of cashier's checks resolves itself into paying an obligation against itself by issuing another form of obligation against itself and finally paying this out of its reserve funds. To illustrate: A customer desires a cashier's check to use in a real estate transaction. He closes his savings account and receives a cashier's check for the amount. Interest ceases on the savings account on the day the check is drawn. The bank receives back the cashier's check for payment five days later; but in the meantime it has not disturbed its balance with its city correspondent, which continued to draw interest; and the draft which finally pays the cashier's check does not reach the depositary bank until a week after its issue—obviously a profitable transaction.

Each cashier's check issued must have a corresponding debit, the entry for the check constituting a credit, or liability. To this end we must have an offsetting debit for every check issued. Such checks are used in various departments, and are issued upon requisition ticket giving the number of the check, date, to whom issued and amount. This ticket constitutes the entry to balance the cashier's check issued.

The *cashier's check register* will record checks issued by date, number, to whom issued, amount, when paid, and account to be charged, with remarks. Cashier's checks arising in different departments may be indicated by a distinguishing letter prefixing the number, thus "L" for loans made. Assuming that a loan is made to a customer and cashier's check is issued the entry would be:

Debit loans	$1,000	Credit cashier's check L-509	$1,000

The amount of checks issued each day is carried to the journal and then to the general ledger. Likewise the amount of checks paid As these instruments are received for payment they are sorted numerically (and if used in departments first by department letter prefixes) and examined as other checks are for regularity and indorsements They are compared with the check register and marked as paid. The unstamped items should prove in total with the general ledger.

Christmas Club.—The Christmas Club, now found in a great many banks, has grown to enormous proportions, it being estimated that upwards of $200,000,000 was sent out by the banks of the country for the Christmas Clubs of 1922. These are essentially savings deposits made at weekly intervals during the year, to be returned automatically in December. The depositor who "joins the club" agrees to deposit a certain amount weekly for about fifty weeks As a receipt he holds a card, coupon book or pass book, according to the system used At the close of the club year he receives his Christmas check from the bank, which closes the account. These deposits are not payable at any other time, and are essentially time deposits. The amount is carried to "Christmas Club Account" in the general ledger from day to day, and should agree with the total shown on the cards in the Christmas Club department

Unpaid Dividends.—When a dividend is declared the amount is credited as a liability of the bank, and checks are sent out to the stockholders. As they are presented for payment they are charged to this account and the amount here shown represents the amount of checks still outstanding. A special dividend cashier's check is used for this purpose to distinguish them from regular cashier's checks.

Nominal Liability Accounts.—It is a rule of accounting that when an asset is received into a concern a liability must be set up to offset it. Under this rule we have in banks several nominal liability accounts that represent funds received from various sources, which go into the assets. They are earnings of the bank and will eventually be carried into profit and loss account. In order to make these credits in bulk, nominal liability accounts are created to hold these amounts until the books are closed. The principal item is interest received.

Interest Received.—Into interest received account is carried all interest and discount received by the bank The account may be divided into various divisions to show the source of the income and this is advisable inasmuch as the income must be classified in making up income tax reports. Such a division would be·

Discounts received
Interest on balances with other banks
Interest on Liberty Bonds, giving issues.
Interest on municipal and other tax exempt bonds.
Interest on loans.
Interest on mortgages.
Interest on other securities.

Rebates of interest on notes paid before maturity would constitute a charge against interest received and be deducted from discounts. Interest paid on securities bought (accrued interest) is properly chargeable to this account, inasmuch as the interest when received will form a credit The charge should be made against the class of securities to which the purchase belongs, thus showing the net amount received.

Protest Fees.—Where the fees received for protesting negotiable instruments constitute an earning of the bank, as they should, the fees are carried to "protest account."

These fees, while small in their units are large in the aggregate and require many small entries, unless they are put through in bulk at the end of the day. Journal entry.

Debit—customer
Credit—Protest-account

Exchange.—This account holds the fees collected as exchange. These also are small in the individual transaction but large in the total. Where exchange is still charged on checks this account will be substantial, but where exchange is only charged on collections it will be more modest. The journal entry for exchange collected on a draft paid by charging a customer's account will be as follows:

Debit:	Customer's account	$1,000	
Credit.	Cashier's checks		$999
	Exchange		1

Rent.—Where the bank owns its own building and rents safe deposit boxes, there will be two rent accounts, rents from bank building and rents from boxes. The credits to these accounts are self-evident.

Accrued Taxes, Expense, Etc.—Any charge against a bank that is running constantly, and yet is paid only at stated periods should be set up as a liability from time to time, so that the amount may be provided for in advance and that the position of the bank may not be misstated. We know that certain taxes and expenses will fall due at certain times. The exact amount may not be known but may be approximated from previous experience. For instance, the taxes on real estate are known within a reasonable limit, likewise the income tax and capital stock tax. If these amounts are totaled for a year and divided by twelve, the monthly charge may be ascertained. Each month one-twelfth of the amount is charged to "taxes" and credited to "taxes accrued." When the taxes are paid they are charged to taxes

accrued, thus eliminating this item from the statement in due course. Statements taken off under this plan will reflect the true condition of the bank.

Accrued Interest Payable.—The interest charges for a year may, like taxes, be approximated and set up in monthly charges, the same as taxes are set up, and reduced by proper entries when the interest is finally credited to the depositors. The interest that is paid monthly does not need to be charged up as accrued; but interest that accumulates for a period of three or six months should be set up from time to time, in daily, weekly or monthly charges to interest paid, and credited to interest accrued account. (The term "*accrued* interest" is generally used to designate interest running *to* the bank; interest *accrued* is used to indicate interest running *against* the bank.)

Where the bank operates a savings department which credits interest semi-annually, the amount may be prorated over the period, and set up as a liability. Thus, having a savings department with $2,000,000 deposits on which 4 per cent is paid, the charge will be approximately $80,000 a year, or $6,666.66 per month. At the end of each month this amount is charged to interest *paid* and credited to *interest accrued.* When the period is ended, the amount is charged to interest accrued and any balance is credited back to interest paid. As a matter of fact, a bank paying 4 per cent will find that the interest cost is somewhat less than 4 per cent due to withdrawals and short time deposits. The exact cost of money in this department may be found by dividing the amount of interest credited at the end of the period by the *average monthly amount due depositors.*

Thus, we find that the interest credited savings depositors on Jan. 1, 1924 to have been $36,450. The monthly balances due in this department were:

July 1	$1,850,000	
Aug. 1	1,900,000	
Sept. 1	1,800,000	
Oct 1	1,925,000	
Nov 1	1,975,000	
Dec 1	2,000,000	Total $\frac{\$11{,}450{,}000}{6}$ = $1,908,330

$36,450 divided by $1,908,330 equals .019 per cent or at the rate of .038 per cent per year.

Unearned Discount.—In considering unearned discount, let us take an example that will show the reason for unearned discount and the process of its computation.

A note for $1,000 having ninety days to run is discounted as of Oct. 1. The discount $15 is immediately credited to discount received. It is apparent that this $15 is not earned on Oct. 1, but is earned day by day until the time has expired. We are called upon for a statement of the bank as of Nov. 15. It is obvious that at that time one half the $15 has been earned and at the same time $7.50 has been received that the bank has not yet earned Therefore we set up as a liability $7.50 as "unearned discount" to eliminate this amount from our calculations. By this process of reasoning we find that all notes maturing on Nov. 16 have had one day's interest entered as an earning that should come out. Notes maturing Nov. 17 have two days' interest that should be taken out. If we take each day's maturities after Nov. 15 and figure the number of days past Nov 15, and compute the interest at the rate the notes carry, we will have the amount of interest received but not earned up to Nov. 15. The summation of these amounts will constitute the item "unearned interest" on a bank statement Where notes carry different rates of interest, they must be classified according to their discount rate, and many banks do so in some record that provides for such classification. There is no simpler way than this to compute

the unearned discount; but it only gives the amount at the time a report is made up. For a more elaborate system of computing the unearned discount and one which gives the status of this item day by day, the Hanover National Bank of New York will send upon request a complete guide for making these calculations. It is too complex to be reviewed in a work of this kind.

Rediscounts. Borrowed Money.—In many statements will be found an item such as "rediscounts" or "borrowed money" etc. In the former case it means notes rediscounted with the Federal reserve bank or correspondent bank, in the latter it represents funds borrowed from the same institutions against Liberty bonds or other securities.

Banks borrow or rediscount for the following reasons

1. Deposits are "running off" faster than deposits are being made and the bank must borrow on its securities or sell some of its paper discounted to place itself in funds to meet these withdrawals. The bank is paying out more funds than it is receiving, and must cover itself, it may be temporarily, by borrowing rather than selling securities. In case it rediscounts, it anticipates the maturity of some of its paper.

2. The reserve may be below the required limit and borrowing or rediscounting will restore the same.

3. Loans have been made to the extent of exhausting the loanable funds and the bank, in order to continue loaning, borrows. If it rediscounts it sells one loan in order to make another.

4. Loans have been credited as deposits faster than the reserve ratio permits, so that the increasing liability on deposits has reduced the reserve ratio It is restored by borrowing or rediscounting.

Customers' Ledgers.—A large part of bank bookkeeping has to do with accounts of depositors. To

the bookkeeping department flow the checks drawn by the customers of the bank, and presented through the clearing house, by messengers, and over the counters. Each check must be examined for the points set forth under Chapter X after which it goes to the bookkeepers for charging against the account. The deposit tickets go from the receiving teller to the same department for credit. Both deposit tickets and checks must be sorted alphabetically, listed for proving purposes, entered upon the records, and after the work is in proof they are filed. The deposit slips are filed where they can readily be had for subsequent use and the checks are filed for the purpose of furnishing statements and balanced books to the customers. It follows that this work is a daily grind, the flow of checks and deposits being constant, and varying with the time of the year, time of the month and general activity of business.

The division of depositors' accounts, which all banks find it necessary to make, depends upon the nature of the business. A small country bank will have but two, namely, the checking accounts and the savings accounts. The former may be grouped according to alphabetical divisions and the latter numerically into blocks. In a large bank handling a large number of bank accounts, there will be a special bank ledger, divided alphabetically or geographically as preferred, while the other groupings are satisfactory, no matter how large or small the bank may be, if made *alphabetically* for checking accounts and *numerically* for savings accounts. The checking accounts may be grouped into corporation and personal accounts, should the size of the bank warrant such segregation.

The Boston Ledger.—Defying time to make it obsolete the Boston ledger has outlived nearly all other forms of bank bookkeeping. It succeeded the old-time ledger with the debits on one side and the credits on the other, the difference being noted in pencil, which is still found in a few banks that have adhered to an old idea. The chief defect of the latter system is the proof, which necessitates the listing of each account on a trial balance sheet, and besides it is a slow method of posting. The Boston system has been used by practically all banks that date back a quarter century, and is still in use in many banks today, but is being rapidly supplanted by the machine bookkeeper, hereinafter mentioned.

The Boston ledger is based upon the idea of eliminating all needless work, such as dating and writing of names frequently. Amounts in the proper columns is the secret of its longevity. The names are written or printed on a master page, either on the margin or in the center of the page. Several narrower pages are inserted, so that the name can be read as the leaves are turned over. This makes one writing or printing last from three to six months. It is generally a large book and costly, if names are printed. Spaces are left for new accounts, the arrangement being alphabetical down the page. The accounting is done across the page.

Next to the name will be the balance carried forward; next the credits for the day, then the debits, and the balance after the net difference is ascertained.

Each day has a space with "old balance," "deposits" or "credits," "checks" or "debits" and "new balance." It is customary to post the credits itemized, but the checks, being numerous, are usually run up on the adding machine and treated as one entry, with the notation "Lst" (list) to indicate that more than one check is included in the entry. Where the checks are few—

			Monday, 191				Tuesday, 191				Wednesday, 191			
NO.	NAME	BALANCE	CHECKS IN DETAIL	TOTAL CHECKS	DEPOSITS	BALANCE	CHECKS IN DETAIL	TOTAL CHECKS	DEPOSITS	BALANCE	CHECKS IN DETAIL	TOTAL CHECKS	DEPOSITS	BALANCE
1														
2														
3														
4														
5														
6														
7														
8														
9														
10														
11														

FORM 35 —Boston ledger

two or three for the day, they may be posted singly. Debits, such as certified checks are marked "CC", charges such as notes paid, "DM"— *debit memorandum;* returned items "RT," etc. Credits such as notes discounted are marked "ND"—*note discounted,* sometimes with the face amount, discount and net proceeds, other credits, such as collections are marked "C" and other credits "CM"—*credit memorandum.* This distinguishes other entries from the regular checks and deposit entries. Many banks post the checks received through the clearing house with a colored ink to distinguish such items from the regular work. The bookkeeper must make an addition and subtraction on each account that changes during the day and carry the balance to the balance column, indicating overdrafts in red ink. Each page can be proved by itself, since the total of the old balances plus the deposits and credits, minus the checks and charges must equal the total of the new balances. When a page does not prove, the individual accounts must be examined to discover where the error occurred.

It is obvious that such work is mechanical in the highest degree. The work is monotonous and trying at best, inasmuch as it is a constant mental strain. It develops a man's staying powers and teaches him to concentrate, and be accurate in addition and subtraction. The Boston ledger is a good training school, but bank men as a rule work in this department no longer than is necessary.

As a preliminary to posting, the debits and credits are listed on a scratcher or tickler, which is merely a journalization of the items for the day. When the ledger posting is complete the items are checked back to the tickler, thus assuring that all entries have been made to the right account. The totals are carried from the tickler to the general ledger and the Boston ledger must of

course agree with the latter. The tickler will classify the items into the same groups as are included in the ledgers themselves, and it therefore acts as a control over the ledger accounts. This process involves the writing of all depositors' names daily in the tickler and is a task that is shunned on account of its monotony. The work can be lightened by using initials only or grouping all items under the alphabetical arrangement. At best the Boston system is tedious although accurate. The chief defects are:

1. It must be transferred frequently. Some banks do so quarterly and others semi-annually.
2. Adequate provision cannot be made for new accounts. Spaces are left for the insertion of new names, but the number of new names cannot be known and when spaces are filled they must be carried in the back of the ledger until a new one is opened.
3. There is danger of posting on the wrong line when the item is at the opposite side of the ledger page from the name.
4. The work is entirely mental and all additions must be made mentally.
5. In tracing back an account several ledgers may be brought into use.
6. Accounts that are inactive must be carried forward constantly and much needless work done in handling such inactive accounts.
7. Where there are more than three or four checks a day they must be grouped and cannot be itemized.

Writing Up Pass Books.—Where the Boston ledger is in operation the pass books must be written up, unless the statement system is in vogue. Obviously this cannot be done unless the pass book is left at the bank for that purpose. This has one decided disadvantage: It deprives the customer of the use of the book for the time it is in

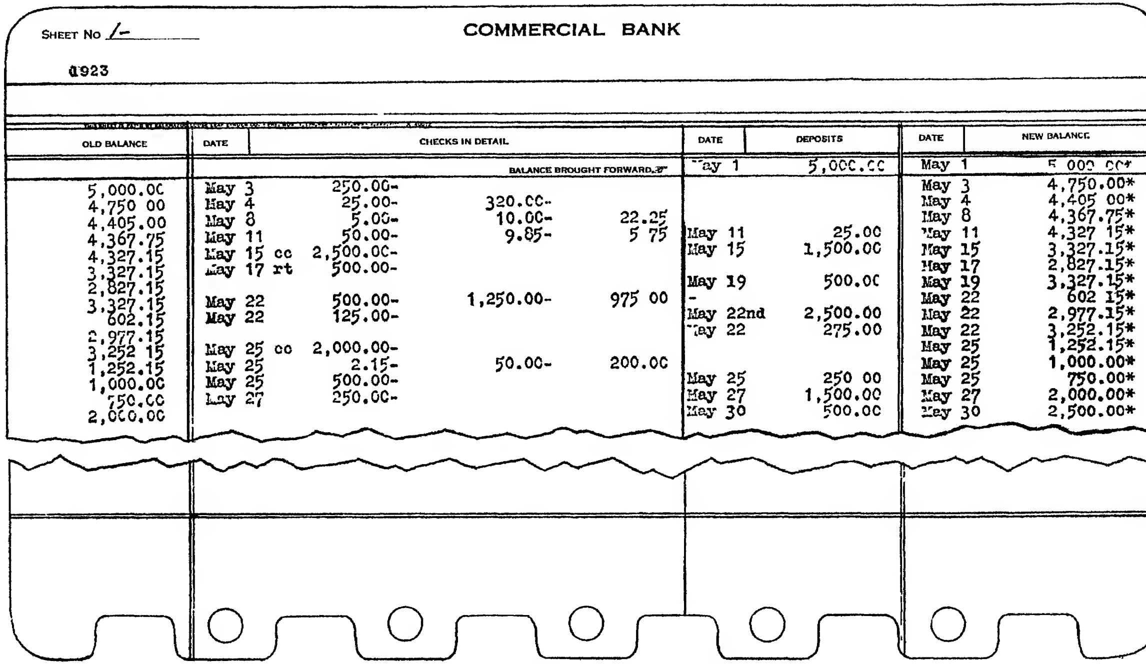
the bank for balancing, necessitating the verification of deposits made during the interim before entering in the book. In balancing the pass book, the bank adds the deposits to the last balance shown by the book. The checks are run up on the adding machine. The difference between the first and second operations is the balance and should agree with the ledger. If not, missing entries are looked for in the ledger and posted in the book; missing checks from the vouchers are traced, and if necessary the run up and pass book are checked with the ledger, until the discrepancy is found. When the book and ledger agree, the ledger is marked "Bal." indicating that the book was balanced as of that date. The great disadvantage in balancing pass books lies in the fact that they come into the bank at the end of each month thus making overtime work necessary. A fast worker can balance from five to ten books per hour depending upon the volume of checks passing through and the frequency of missing entries to trace down. The ledgers are not available during the posting periods and much of the work must be done while the bookkeepers are not using the ledgers.

Statements.—Many banks which are still using the Boston ledger supplement it with a statement system operated either by hand or machine. This eliminates the balancing of pass books and is a decided advantage After being posted to the ledgers, the same items are given to statement clerks who make similar postings on loose leaf sheets. The balances as brought forward by the statement clerks are called back to the ledger men, and the two must agree. Both have the same balance at the beginning; both have made the same debits and credits and consequently both must get the same result

At the end of the month the statements are made up and sent to the customers, either by mail or over the

counter upon call. Before being sent out, the vouchers are counted and must agree in number with the entries; the amounts must agree; and the balance must agree with the ledger. Acknowledgment slips are attached to the statement, on which the customer certifies that he has examined his balance and vouchers and finds them correct. In some states, notably New York, any claim for forgery, alteration, or other irregularity must be made within one year of receiving the statement or any right to claim reimbursement from the bank is forfeited

Machine Posting.—The bank bookkeeping machine is fast supplanting the Boston ledger with all its old time honors It is not only much quicker, but eliminates the strain of constant addition and subtraction It reduces the labor cost of banking considerably, inasmuch as one machine operator can do the work of at least three ledger men It is entirely a mechanical process, extremely neat and highly accurate The work consists of two parts, the ledger, which is loose leaf, and the statement, a duplicate of the ledger in every respect except the heading. The items are exactly the same. The accounts are grouped as may be desired, the ledger and statement being in the same order, and a control account set up on the general ledger for each group. Checks and deposits are sorted alphabetically for each ledger and run up on deposit and check lists which show the total debits and credits for each ledger. The total of the check and deposit lists will equal the amount charged to the bookkeeping department by the tellers. The amounts are then posted by the machine operators, each account that shows a transaction being offset. When all postings have been made, the same items are turned over to the statement clerks who do the same work on the statement sheets. The offset sheets are called back and must agree.



SHEET NO /-

COMMERCIAL BANK

1923

OLD BALANCE	DATE	CHECKS IN DETAIL			DATE	DEPOSITS	DATE	NEW BALANCE
				BALANCE BROUGHT FORWARD	May 1	5,000.00	May 1	5,000.00*
5,000.00	May 3	250.00-					May 3	4,750.00*
4,750.00	May 4	25.00-	320.00-				May 4	4,405.00*
4,405.00	May 8	5.00-	10.00-	22.25			May 8	4,367.75*
4,367.75	May 11	50.00-	9.85-	5.75	May 11	25.00	May 11	4,327.15*
4,327.15	May 15 cc	2,500.00-			May 15	1,500.00	May 15	3,327.15*
3,327.15	May 17 rt	500.00-					May 17	2,827.15*
2,827.15					May 19	500.00	May 19	3,327.15*
3,327.15	May 22	500.00-	1,250.00-	975.00	-		May 22	602.15*
602.15	May 22	125.00-			May 22nd	2,500.00	May 22	2,977.15*
2,977.15					May 22	275.00	May 22	3,252.15*
3,252.15	May 25 cc	2,000.00-					May 25	1,252.15*
1,252.15	May 25	2.15-	50.00-	200.00			May 25	1,000.00*
1,000.00	May 25	500.00-			May 25	250.00	May 25	750.00*
750.00	May 27	250.00-			May 27	1,500.00	May 27	2,000.00*
2,000.00					May 30	500.00	May 30	2,500.00*

FORM 36 —Machine posted ledger

A complete proof of the ledger is taken daily, semi-weekly, or otherwise. By so doing, errors are restricted to a limited time, and are easily found. The list of the deposits and checks as made on the check and deposit lists are in the same order as the postings are made on the ledger, and although names are not used in making the check and deposit lists, it is an easy matter to check back the ledger with the lists.

Before postings are made the amounts are totaled for each ledger group so that a control can be had over the balances shown therein. Thus, in a large batch of checks received for posting, after sorting according to ledgers, there will be 100 checks for ledger A-C. These amount to $5,000. The deposits are likewise classified and totaled and are found to be $3,000 for this ledger. When the debits and credits are posted the amount due depositors as shown by this ledger will be $2,000 less than the day before. In short, the checks are charged against the ledger in bulk, and deposits are credited in the control account, and the total of the balances as shown by the ledger must agree with these figures.

The statements rendered customers in the machine system follow the same general order as the statements made in the Boston ledger system. The former is an exact duplicate of the ledger account, and the other is a transcript of the ledger work in a different form. Both achieve the same results, insofar as the customer is concerned. Both give the customer an itemized statement of the account for the period covered.

In a bank where the machine system has been in vogue for five years and where it has given perfect satisfaction, the following procedure is operative in the postings: The checks are charged out of the

STATEMENT

FROM________________

TO________________

________________ VOUCHERS RETURNED

CAPITAL $100 000
SURPLUS & PROFITS, $100 000
SAFE DEPOSIT BOXES $2.50 TO $10 00 PER YEAR
INTEREST ACCOUNTS
HOUSEHOLD ACCOUNTS
CHECKING ACCOUNTS
CHRISTMAS CLUB
TRUST DEPARTMENT
OPEN SATURDAY NIGHTS

COMMERCIAL BANK

OLD BALANCE	DATE	CHECKS IN DETAIL			DATE	DEPOSITS	DATE	NEW BALANCE
			BALANCE BROUGHT FORWARD		MAY 1	5,00000	MAY 1	5,00000 *
5,00000	MAY 3	25000 —					MAY 3	4,75000 *
4,75000	MAY 4	2500 —	32000				MAY 4	4,40500
4,40500	MAY 8	500 —	1000 —	2225 —			MAY 8	4,36775 *
4,36775	MAY 11	5000 —	987 —	575	MAY 11	2500	MAY 11	4,32713
4,32713	MAY 15 CC	2,50000 —			MAY 15	1,50000	MAY 15	3,32713 *
3,32713	MAY 17 RT	50000 —					MAY 17	2,82713 *
2,82713					MAY 19	50000	MAY 19	3,32713 *
3,32713	MAY 22	50000 —	1,25000 —	97500	MAY 22 ND	2,50000		
					MAY 22	27500	MAY 22	3,37713 *
3,37713	MAY 22	12500 —					MAY 22	3,25213 *
3,25213	MAY 25 CC	2,00000 —						
	MAY 25	215 —	5000 —	20000 —			MAY 25	99998 *
99998	MAY 25	50000 —			MAY 25	25000	MAY 25	74998
74998	MAY 25	25002 —			MAY 25	1,50000	MAY 25	1,99996
1,99996					MAY 30	50004	MAY 30	2,50000

BALANCE	JUN 1	2,50000	JUN 1	2,50000 *

C M.—Credit Memo
N D—Note Discounted
CL—Collection
IN—Interest
E C—Error Corrected

RT—Returned Item
C C—Certified Check
D M—Debit Memo
EX—Exchange

Please examine this statement upon receipt and report at once if you find any difference so that we may know definitely whether our books agree with your own. If no error is reported in ten days the account will be considered correct. All items are credited subject to final payment.

RECEIPT FOR VOUCHERS HERE

FORM 37 —Statement

cages to the bookkeeping department. They are sorted according to ledger groupings and alphabetically. Deposit tickets are treated in the same manner. The postings are then made, deposits and checks at the same time. Any checks that are short are taken out of the work and off the teller's charge outs. The items are then run up on the deposit and check lists and the totals must agree with the teller's lists. The advantage of this plan is that it avoids the necessity of taking the returned checks off the check list, which would be the case if the check list were made before posting. If errors show up in the proofs, the check lists are checked back with the ledger postings. Inasmuch as the items follow through the ledger in the same order as they appear on the check lists, any discrepancy is quickly found. The ledger posting is made by one clerk, the statements by another and the check and deposit run-ups by another. It is obvious that the three will not make the same error in reading a check. Most of the discrepancies arise by reason of blind figures.

Duty of Depositor to Examine Vouchers.—In order that banks may not be subject to claims arising from forged and altered instruments for an indefinite time after the depositor has been placed in position to detect the forgery or alteration, the New York Negotiable Instruments Law provides that

> No bank shall be liable to a depositor for the payment by it of a forged or raised check, unless within *one year* after the return to the depositor of the voucher of such payment such depositor shall notify the bank that the check so paid was forged or raised

It has been the custom of banks from time immemorial to render statements of account to their depositors. The old custom was to write up the pass book at monthly periods or upon presentation, this writing up consisting

of balancing the pass book with the bank's records. The present custom is to render statements on separate sheets, giving the debits and credits for the period covered. The vouchers paid during the period are returned, properly cancelled.

Many of the losses suffered by banks would have been avoided had the depositor examined these returns and compared the vouchers with his own records, to determine: (*a*) If the bank's balance agreed with his own; (*b*) what checks were outstanding; (*c*) what checks, if any, had been improperly paid. Where trusted clerks have been forging and otherwise falsifying the accounts, it could have been detected by this checking process. And where checks have been raised or altered, or fraudulently issued, they too would have been detected

It was formerly held that the depositor owed the bank no such duty, but now it is well settled that the depositor owes a duty to the bank to make such an examination for the purpose of detecting irregularities in the account Good business management would also sanction such a rule. This examination should be made within a reasonable time, and should be made with promptness in order that further irregularities may be checked. Therefore we have the New York rule, which is above given, and which is just and reasonable.

While the examination should be made by the principal, this is obviously impossible in many cases and must be delegated to others; and where it is done by one so authorized, it will bind the principal; although good business demands that it shall be done by one who is not responsible for the issuance of the checks.

Many banks have notation on their statements to the effect that if the customer reports no discrepancies within a certain time the account will be considered accepted as stated; while other banks require an acknowledgment

that the vouchers have been received and examined and found acceptable.

As a general rule, this examination must be made within a "reasonable time." The examination must also be made with a reasonable degree of care and cannot be perfunctory only. At the same time, the depositor owes no duty to the bank to examine the indorsements on the vouchers. The bank's contract is to pay only upon genuine indorsements, and the depositor is in no position to know whether the indorsements are genuine or not, and must rely upon the bank in this respect. The authorities are well agreed that this burden is upon the bank and cannot be shifted to the depositor. Consequently any payments made upon forged indorsements are subject to recovery Upon discovery that forgery or alteration has been committed, the depositor must advise the bank promptly of the facts in order that it may be placed on guard against further practices of the same kind. Waiting an unreasonable length of time to make this notification may lose him his right to recover. This rule is based on the fact that having prompt notice it may proceed immediately to protect itself and to apprehend the guilty party, and delay in notification may prejudice the bank in recovering.

Return of Cash Items.—Where an item is returned as unpaid and has been received as a cash item it will not be given further treatment unless the depositor so requests, in which case it will go to the collection department. If it is not to be given special treatment, it will be charged directly to the depositor under the rule that indorsers guarantee payment and are to be held responsible for unpaid items. Returns of this nature may be sent by messenger to the depositor, if convenient, but more often they will be charged to the account and

returned by mail with proper record of return. Where the depositor elects to reimburse the bank in cash, he may do so; or, he may draw his check. The most common practice is to return the item, charging the account Two tickets are made out, one going with the item and the other constituting the charge against the account.

"Holds."—It frequently becomes advisable for a bank to hold or agree to hold funds on deposit, for a certain purpose. Thus the note teller may have a note due and advises the bookkeeper to hold the amount. Against the balance the bookkeeper would mark in pencil "Hold $ NT," meaning hold the amount for the note teller

Paying Checks on the Bank Itself.—Inasmuch as the bank is constantly paying checks, notes, acceptances, etc , drawn on itself, it follows that all such items must be assembled in one central place and there reassorted according to the ledger grouping of the bank. This is commonly called the "check desk" but may be a large department in itself. In this department the accounts of the bank's domestic customers are handled. All credits to the customers go through this department and all charges against them likewise are handled here

Checks will be received from the mail teller, paying and receiving tellers, note teller (in payment for notes acceptances, etc.), clearing house department, and other departments receiving checks drawn on the bank itself, such as the loan and the collection departments. The department from which the check has been received is stamped on it, or indicated in some other way, such as cutting with a peculiar spindle. Stamping is the most satisfactory, inasmuch as it does not mutilate the check. Checks as received are verified with the

accompanying tickets. In banking the receiving agent does not accept the sending agent's work without proving. Whatever is received is checked. In receiving a batch of checks they will first be proven, and then sorted. This sorting may be as follows:

(*a*) Certified checks (already charged, but which must be credited to certified check account).

(*b*) Cashier's checks, dividend checks, Christmas checks, etc., and any items to be charged back to the customer.

(*c*) Customers' checks.

After sorting they go to the bookkeepers for posting.

Each check going through this department and to the bookkeepers is examined for date, filling, signature, indorsements, stop payment, balance, and uncollected funds—the latter two being passed upon by the bookkeepers. Irregular checks, short checks, checks drawn against uncollected funds, altered or forged items are returned to the source from whence they came and taken off the proof. In such a department all checks received are debited and all checks sent out are credited so that at the end of the day, when the work is all out of the department, the work will be in balance, showing that the department has accounted for all it has received.

Average Balances.—In discussing the fundamental principles of banking, we found one of the rules to be that for every dollar borrowed the customer is expected to keep 25 cents on deposit. In other words his average balance should be one-quarter his loans. To determine this the average balance and the average amount of loans must be known. This information is needed also in paying interest which is paid on the average balance, less average loans, less free balance. An average balance book is kept in which is recorded under

the name of the depositor the amount, in round figures, of the balance each day. This may be done by the bookkeeper for his own ledger, and could be kept as part of the ledger itself and carried into a monthly summary book. At the end of the month the amounts are totaled and divided by the number of days, the result being the average daily balance for the month. On this sum interest is computed, as discussed under "Interest on Daily Balances."

Interest Delays.—In paying interest on deposits, it is essential that the bank shall not pay interest on money which it cannot use as reserve or for loan purposes. It is necessary to eliminate such amounts from the sums on which interest is paid. Where exchange is paid on certain items it is assumed that the exchange covers the interest delay and the depositor is entitled to interest on the full amount from day of deposit. On all other items the time for collection must be considered. It is therefore necessary that all items be analyzed in the bank, in some department for the purpose of computing the amounts for which interest is delayed.

Uncollected Funds.—One of the great dangers in banking is the payment against uncollected funds. This has two aspects: (*a*) The bank in paying against uncollected funds advances its own funds without interest until it has made the collection; and (*b*) the uncollected item may be returned, thus creating an overdraft or a loan without security. The bookkeepers have it within their power to prevent this practice, and they are chiefly charged with this duty. In fact no other employees of the bank have the opportunity to watch this feature.

It would be difficult to describe the exact process by which this practice may be prevented. The bookkeeper must "use his head" and keep his eyes open and his

mind alert. He must have the ability to scent danger. On many accounts there need be no watch set, because the balances are ample and the depositor does not draw checks as fast as deposits are made. On other accounts the balances are small and checks are drawn as fast as balances are created. The bookkeeper will soon learn which accounts bear watching As he posts his items his eye unconsciously turns to the deposits last made and if the checks exhaust that deposit and cut into the previous balance, he knows that the customer is drawing on the uncollected funds unless the deposit was composed of checks on the bank itself, cash, or local checks cleared the next day. In other words the bookkeeper must know the composition of each deposit.

COMMERCIAL BANK

In account with

19

		Dr.		Cr.		
	27					
	28					
	29					
	30					
	31					
	1					
	30					
	31					
		Interest				

FORM 38—Form for calculating interest on daily balances

This is one redeeming feature of the Boston ledger, inasmuch as the work is done by pen, the bookkeeper may make note alongside a deposit as to its character. Thus in entering a deposit he will find several out-of-town checks that will take three days to collect. He makes note on the account to "Hold $1,000–3" meaning hold

back payment on $1,000 for three days from the date. In machine work with the rapidity of the posting, these notations are not so easily made and head work comes into play. In every bank there are certain accounts that are known to be bordering on the danger line all the time and as such should be given constant thought Before paying any checks on such accounts the sufficiency of balance must be ascertained. Checks are returned for uncollected funds as frequently as they are for insufficient funds. The bookkeepers must know the character of each depositor's business and his banking habits and guide himself accordingly.

The possibility of loss through this medium may be seen from two actual examples A bank in New York had an account of this character Checks were drawn in large amounts daily, against deposits consisting of checks on out of town banks. On a certain morning it had presented $12,000 of checks drawn against a deposit of the same amount, which consisted of checks on banks that would pay in three days. The payment of the deposited checks was due on the same day.

Assuming that the checks had been cleared, the checks were paid. Shortly thereafter the checks deposited came back "uncollected funds" and the result was an overdraft of $5,000 which had to be taken up by a note of the depositor. The proper course would have been to have wired the bank on which the checks were drawn to ascertain if they had been paid.

In another case an account was opened with a customer known to be working close to the danger line and his account was marked. "Pay nothing against uncollected funds." A check was deposited for $1,000 drawn on a western bank. Shortly thereafter a check for $700 came through the clearings and was returned "uncollected funds." The western check proved a fraud and the bank

was safe; otherwise it would have been out $700. In the Journal of the American Bankers' Association for November, 1922, appeared this item:

> **$4,000 for $15 Worth of New Business**
>
> A recent fraud perpetrated against a member bank located on the Canadian Border illustrates the danger of making payments against uncollected items
>
> It shows the risk you take in giving bank recognition to any person however impressing his personality, until the paper deposits have been collected
>
> A stranger opened an account on the tenth of the month by depositing $5 in cash
>
> On the following day he made a deposit of $10
>
> On the sixteenth this new "customer" presented for credit a draft for $5,250 issued by a bank in Montreal The following morning, before there was time for collection on this item, he came back and induced the bank to give him a cashier's check for $4,000 payable, not to himself but to a third party
>
> The stranger thereupon proceeded to convert the $4,000 check into bonds From another bank in the same city he purchased three $1,000 Liberty bonds and ten $100 Liberty bonds tendering in payment the $4,000 check
>
> At first unwilling to accept the check from a stranger, the banker selling the bonds called up the issuing bank, asked if the $4,000 check was genuine and was assured that it was Later the bookkeeper of the bank selling the bonds also telephoned the issuing bank and received similar assurance So the bonds were delivered to the purchaser
>
> The draft on the Canadian bank took the usual course and in due time there came notification that it was a forgery
>
> Do not cash checks for strangers and do not give strangers credit against uncollected items
>
> $4,000 is too much to pay for a $15 account

It is obvious that had the bank been on guard against uncollected funds this loss would not have occurred.

It is impossible to lay down an absolute rule to guard against uncollected funds. The bookkeeper can be of

inestimable worth to his bank if he is keen enough to catch such operations as they pass before his eyes. Eternal vigilance is the only price of safety in banking and this vigilance devolves upon the bookkeeping staff.

THE CORN EXCHANGE BANK

WILLIAM AND BEAVER STREETS
NEW YORK

A Bank Statement that any Man or Woman can understand

May 1, 1923

	The Bank Owes to Depositors	**$212,567,927.88**
	A conservative banker always has this indebtedness in mind and he arranges his assets so as to be able to meet any request for payment.	
	For This Purpose We Have.	
[1]	**Cash**	$29,415,628.21
	(Gold Bank Notes and Specie) and with legal depositories returnable on demand.	
[2]	**Checks on Other Banks**	28,184,566 14
	Payable in one day	
[3]	**U S Government Securities**	64,037,650.86
[4]	**Loans to Individuals and Corporations**	25,783,902 48
	Payable when we ask for them secured by collateral of greater value than the loans.	
[5]	**Bonds**	24,416,443 92
	Of railroads and other corporations, of first quality and easily salable.	
[6]	**Loans**	51,118,188 11
	Payable in less than three months on the average, largely secured by collateral.	
[7]	**Bonds and Mortgages and Real Estate**	5,754,342 19
[8]	**Thirty-one Banking Houses**	5,139,068 05
	The head office building stands on our books at $1 675 000 and the thirty branch buildings at $3,464 068 05, all located in New York City	
	Total to Meet Indebtedness	$233,844,789 91
[9]	**This Leaves a Capital and Surplus of**	$21,276,862 58
	Which becomes the property of the stockholders after the debts to the depositors are paid and is a guarantee fund upon which we solicit new deposits and retain those which have been lodged with us for many years.	

Our listed resources, enumerated in this statement, do not and can not include those assets of friendliness and helpfulness which this bank has in the personnel of its board of directors its officers and employees. These are assets which pay dividends to our patrons in service and satisfaction.

The Corn Exchange Bank is prepared to supply you with Banking and Trust Service through its Fifty-four Offices located in Greater New York.

MEMBER NEW YORK CLEARING HOUSE ASSOCIATION AND FEDERAL RESERVE SYSTEM

FORM 39—Simplified bank statement as used by Corn Exchange Bank, New York, in advertising

Kiting Checks.—No more reprehensible practice obtains in banking than the practice known as "kiting." In this the author has had a practical experience that would be most interesting if placed on paper, but the operation was so intricate that it cannot be explained.

The operator was an individual who has perhaps "kited" more extensively than any of his kind within the present generation. As soon as he was detected and stopped in one bank he would break out in another. A bank account to him was merely an opportunity to kite checks In a period of about three years it is well established that he kited upwards of $10,000,000 in a dozen banks Having control of various companies, he would deposit checks of one company in one bank, and draw against the deposits in the name of another company. At times he used as high as eleven banks, and the process became so intricate that detection was almost impossible. No body, not even he, knew just where he stood A balance in one bank would consist of his own checks on other banks, and the balance in the other banks consisted of his own checks drawn on others Hundreds of thousands of dollars in such checks were circulating all the time and until the banks, working together, held back payment on all his checks until certain of their payment, no one knew the exact position. By such cooperation, his checks were sent back, and in one instance overdrafts of over $100,000 were left as the residue of one operation.

The only way such an operation can be stopped is to send back all checks drawn against uncollected funds, paying only against balances actually known to exist in the form of cash and checks which have been honored. No well-managed bank will tolerate such practices, and as soon as they are in evidence more than due care should be used in honoring such checks A simple kiting operation, which recently came to the author's attention, was as follows· A concern in New York had an account in Brooklyn, one in a bank on Long Island and one in New York. A check would be drawn on its New York bank by the company and deposited to the credit of the

individual in his Long Island account. He would then draw his check on the Long Island bank and deposit to the credit of the company in the Brooklyn bank. The next day he would shift the arrangement in the triangle, and shortly afterward again alter the process of drawing. This was caught by a bookkeeper who noticed the course of his checks and the "matching" of his amounts. By comparing the checks deposited as shown on the deposit tickets, examining the endorsements, and the face of the checks, this was detected almost at its inception and stopped summarily. The other banks were communicated with and asked to examine their records to see what he was depositing with them and a comparison of accounts proved the process to be a kiting operation without question. In such operations the tellers and bookkeepers can also render their bank a valuable service in detecting such unethical and dangerous practices.

Other Books of Record. (*a*) *Liability Ledger*.—It is essential to know the amount every borrower has charged against him both direct and indirect. For this purpose a liability ledger is used. This records, "as maker" the number of the note, amount, date of discount, maturity, maker and indorser, with total of all such items. "As indorser" the same details are taken and the two carried to a total column showing the total loans made for the customer's account. Many banks give a customer a direct line and an indorser's line. The amounts allowed under each are noted on the ledger page, so that he may be kept within the allotted limits The total of this book must agree with the amounts shown under "discounts" on the general ledger, and care must be taken that duplications do not occur in listing a borrower's obligations twice in making the proof. A note appears but once in the assets and it must not be included twice in the proof.

(*b*) *Maturity Book.*—In the maturity book will be listed all the notes held under discount by the bank, grouped according to maturity dates. No *collections* should be entered in this record The total of the maturity book will agree with the "discounts" on the general ledger and with the liability ledger.

(*c*) *Collection Register.*—The incoming collection register records all items received for collection, with a number for each, with the following details: Date of receipt, from whom received, on whom drawn, date of item, amount, when due, papers accompanying, instructions and fate. For a proof of this the unpaid items will check with the records The incoming items will be found in the collection case grouped under due dates They should be checked frequently and all unpaid items followed up and reported on or returned if collection has failed. They should not be held unduly for the convenience of the drawee.

The outgoing collection register will record. Date sent, to whom sent, from whom received, maturity, amount, papers accompanying, instructions and fate. All items should be followed up systematically, by tracers, and if not paid or returned promptly the recipient should be communicated with.

Securities for Clients.—Since the Liberty Loan campaigns made it advisable for banks to afford customers a place of safety for their Liberty bonds, most banks have gratuitously kept such securities for their clients. It follows that there should be a proper control of securities so held. For this purpose the receipts given customers should be in duplicate and numbered. They should describe the securities by name, numbers, and amount. From the receipt book they should be carried to a control ledger alphabetically arranged, showing the class of security, the amount, numbers. The securities are

kept in envelopes alphabetically filed in the vaults. From the receipt book they are entered in the ledger control and checked with the securities in the envelopes. The total of the ledger must agree with the general ledger item "*securities for customers.*" This is not an asset account, however, and for record purposes only. It does not appear in the statement.

As deliveries are made upon return of the receipt, the duplicate is taken out of the book, and attached to the original. The amount is taken off the securities for clients ledger, and the receipts form the charge tickets from which the bookkeeper makes his postings. The receipts still uncancelled will check with the securities in the vaults and the sum of the receipts must agree with the ledger control account.

These securities are not the property of the bank and should not be mingled with the bank's other assets. While a ledger control is desirable if not necessary, this control account does not appear in the bank's liabilities in published statements.

Securities Bought and Sold.—Many banks operate a securities department wherein securities are bought and sold for clients. For this work we have a book of buying orders and a book of selling orders. The sheets are in triplicate, one going to the broker, one to the customer and one retained for record purposes. Orders in numerical sequence should be signed by the customer and if taken by telephone should be so indicated. From the buying and selling records the entries are carried to the buying and selling ledger, sheets being arranged for each in a different color. The buying record will contain: Number of order, date, customer, security, broker, buying price, amount of invoice, number of securities, when delivered, commission, and receipt of the buyer. The selling record will contain: Order

BUYING ORDER FOR SECURITIES

No

Please buy for my account the following securities

at Order good until

I agree to pay for the above at the cost to the bank, plus a service charge of $
and you are hereby authorized to charge the same to my account

Check here for phone order ( )

Date Signed

Received the above named securities in par value of $

Date

FORM 40 —Buying order for securities

SELLING ORDER FOR SECURITIES

No

Please sell for my account the following securities

at Order good until

Securities delivered

Check received

Proceeds credited

Signed

Date

FORM 41 —Selling order for securities.

number, date, security and number, broker, selling price, amount, when received, disposition of proceeds, commission and receipt for proceeds.

Unfilled orders are immediately discovered and followed up, and through this process it is possible to trace all orders subsequently. This avoids the necessity of referring to the broker's invoices for information.

Securities bought for customers may be charged to "*securities bought for clients*" on the general ledger, from which they are charged to the customer's account in the ledger department. If funds are received with the order they may be credited to the securities account as an offset to the payment to be made, but the better way is to credit such funds to the customer's checking account, assuming that the bank deals in such matters largely with its own people.

Any security bought for a client not a regular customer would require payment in advance, or a deposit sufficient to cover the transaction, lest there be a cancellation subsequent to execution, as sometimes happens. In operating such a department the bank must of course know its customers, else it may find itself in possession of securities that it cannot legally own, and may have to sell at a loss. Commissions are carried to commission account, and such commissions may be provided for in the buying and selling orders

Bonds bought for the bank may be put through the same process for record purposes, thus giving a control and a record of such purchases and sales. These items would of course be carried to the securities account in the general ledger. The buying and selling order should be signed by an authorized officer of the bank.

Called Bonds.—A great many bonds are called before maturity according to the terms of their issue. These calls are published in the press, but do not reach the

owners in many cases. The bond houses selling the original offering send out notices to all clients of record that their bonds have been called. Where only part of the issue is redeemed the numbers are published and these are checked with the selling records and sent to the holders of record.

A bank holding securities for customers in safe keeping should follow the same practice and promptly advise all customers holding called bonds. Such lists are sent out by the Wall Street houses, giving the names and numbers of all bonds called to a certain date and these are valuable guides in this respect.

The securities in collateral loans should also be examined for called bonds in order that the owner may take advantage of the call and at the same time not lose interest after the call has become operative and interest has ceased to run on the called bonds.

The same comment applies to the bank's own bond holdings, which if voluminous, will have the call feature to observe frequently. In the readjustment of interest rates in the post war period, a great many issues put out during the high interest period of the war, were called, either in part or in whole and replaced by other issues bearing a lower rate of interest. It is important for all holders of bonds to follow the call features of their holdings. Where securities held for customers are in the form of stock, it is essential for dividend purposes that the stock be registered in the name of the owner, otherwise the dividend will go to the owner of record. This necessitates a refund from the latter which is not always convenient to obtain. Where such securities are held, the bank keeps a record of the closing of the transfer books of various corporations, and dividends declared, and sees to it that the stock is in the name of the true owner before the dividends are paid. Where

the bank acts as trustee of the stock and makes the collection of the dividend for the account of the owner, the stock may be transferred to a nominee of the bank, who will receive the dividends and make proper accounting to the owner. This more properly belongs in the trust department and will be found treated in another volume under its appropriate head.

Telegraphic Transactions.—The banks throughout the country use the telegraph for a great many purposes, not only in the matter of messages of ordinary routine, but in the transfer of money. For this purpose codes are prepared, of which there are several in use. Some banks have their own code, others use the American Bankers Association Code, commonly referred to as the "A. B. A. Code."

The purposes of the code are:

1. Secrecy.
2. To reduce the cost of sending, a sentence being expressed in one code word.
3. To assure that the telegram is authentic through the use of test words applicable to certain days

The large banks have telegraph and cable departments, the former handling the domestic and the latter the foreign business. It is obvious that a message in code must be carefully prepared on account of the import of a single word, which may alter the meaning of the whole message and involve large sums of money. To this end each outgoing message is carefully checked by a code clerk, and each incoming message translated and checked in the same manner. The authenticity of the message is tested by the test words which change frequently and are used to guard against bogus messages.

The telegraph is used largely to effect transfers of money from place to place and in the Federal Reserve System is used very extensively in making settlements

between Federal banks and also between member banks making their clearing house settlements through the Federal reserve banks.

The Federal reserve banks have a private wire system connecting all the banks and branches. Other large banks have similar systems. The wires are used continuously in advising of non-payment of checks, in the settlements for collections, and in the transfer of funds. Thus, a bank in Albany will wish to transfer $10,000 for a customer for his use in New York. The funds will be received by the Albany bank and it will wire its New York correspondent in code to "charge our account $10,000 and pay to the National Park Bank for the account of A. B C" The telegram is authenticated and translated. The account of the Albany bank is charged and a cashier's check is sent to the Park Bank for credit of A. B. C. with instructions to the Park Bank to advise the customer of the credit. Under the present routine the Albany bank would simply wire the Federal Reserve Bank of New York to charge its account and credit the Park Bank for the account of A. B. C. with advice to the Park of the credit. Telegrams of this sort are usually confirmed by letter containing copy of the telegram, which is taken in triplicate when originally made out.

Transfers of funds are frequently made for individuals by wire. Thus a traveling man runs short of money and wires his house to send him funds by wire through a designated bank. The latter will receive a telegram from the depositary bank of the house. "Pay X. Y Z upon identification, $100 draft follows." The house has sent the funds to the bank or given it a check as a charge ticket with advice to make the transfer. Upon receipt of the wire the bank will pay the salesman the amount, upon proper identification, holding the telegram

as a cash memo until the draft is received. A case in point was that of an actor who had an account in New York and was arrested in Los Angeles for violating the traffic laws and lodged in jail He had to have cash bail and could not furnish it He wired his New York bank to send him $1,000 by telegraph through a Los Angeles bank. The New York bank charged his account, wired the funds to Los Angeles, wired him to call or send for the same, and in a few hours he was able to furnish his bond. In this case the New York bank simply placed the funds in the Federal Reserve Bank of New York for credit of the Federal Reserve Bank of San Francisco for the account of the Los Angeles bank, and so advised all parties. Thus no drafts were drawn, the whole transaction being handled by wire.

Where banks have reciprocal accounts, debits and credits are used. The telephone is used in near-by transactions in a similar manner Thus A, in New York, has an account in a country bank on Long Island. He desires to make a quick deposit in the Long Island account for his credit He may take the funds to the New York correspondent of the Long Island bank and make the deposit to its credit in the Domestic Transfer department. Upon so doing the city bank will credit the Long Island bank, and advise it by telephone, confirming the credit by mail advice the next day.

The Mail.—The mail of all banks is heavy. The country banks will receive a larger number of letters than any ordinary business house in a community, unless its operations be nation wide. The city banks likewise receive a large volume of mail, due to the country correspondents carried on their books.

A large part of bank mail consists of remittance and collection letters. The former contain checks for collection, and the latter notes, bills of exchange and accept-

ances for presentation and payment. The registered mail of banks is also heavy.

The mail will contain letters for officers and employees, in the nature of personal mail; bank correspondence requiring the personal attention of special officers or departments; the general mail of the bank in the form of letters containing checks, notes, and other negotiable instruments, intended for the various departments, and circulars, magazines, newspapers, etc., in great volume.

A large volume of the bank deposits are received through the mail, particularly in the cities where the banks make collections for their country correspondents. A letter from a bank in Ohio to a bank in New York containing fifty checks amounting to $5,000 is in no wise different from a deposit made at the window. The bank offers fifty checks for deposit just the same as a local merchant will do. The window deposit is acknowledged by an entry in the pass book; the mail deposit is acknowledged by a card returned to the sending bank. In both cases the bank must have a care that it receives what the depositor purports to deposit.

Good banking requires that all checks be collected promptly and the law demands it Therefore all banks endeavor to get into the work all checks as fast as received. Where the volume of the work is heavy, the city banks have a night force that attends to the mail received during the night, in order that the checks so received may be presented through the clearing house the next morning. The mail is divided into night, morning and afternoon mail. The night mail is the heaviest, since it contains the letters that have been despatched during the previous day from the bank's correspondents and which arrives from early in the evening until the next morning. It would be quite impossible in a very large bank to

open, sort and list the thousands of checks that pour in daily before the opening of the clearing house, although some large banks do not operate a night force, but employ practically the whole force on this work during the early morning hours.

As the mail is brought in from the post office it is sorted into classes, only the letters containing checks, commonly called "cash letters" being taken out for immediate treatment. These are readily recognized by their size.

Whether the bank elects to have a night force which comes on duty late in the evening and works until morning, or prefers to get an early start and employ more men, the operation is the same Every effort is made to get all possible checks in the clearing house for payment on the day of their receipt. It not only gives the sending bank an additional day's interest but quick advice of the non-payment of checks.

It should never be the practice of the sending bank to include in a letter more than one class of items. That is, checks should not be included in letters containing time items and vice versa; nor should coupons be included with other mail. It is not uncommon to have checks, collections, coupons, remittances, etc., all listed on one letter. This may save a little in white paper, but is costly in time; for the receiving bank must deduct all but the cash items. It is, however, quite permissible to make several enclosures in one envelope. This saves postage but does not interfere with the work at the receiving end.

Items that are taken out of regular cash letters are charged to the various departments and taken off the cash footing.

The sorting of the letters may be by groups, as is found convenient for posting and proving purposes.

Whatever division is made in the ledger accounts should be followed in grouping the letters If the ledgers are run by states, the grouping of the letters will be by states, if by alphabet, then alphabetical divisions would be proper.

A "rack" will consist of a batch of checks which have been sorted into divisions on the sorting table. The first essential is to prove the letters as to their contents This may be done by checking the listing as sent in, or by running the items on the back of the letter by adding machine, or by the block system. If the latter method is used the procedure will be identical with the process presented under the receiving teller. There will be, of course, no cash to prove, and the total of the different blocks will equal the total of the letters. Where the checks are proven as to their listing, they are afterward sorted into groups and charged out of the mail department.

Thus, the checks may be grouped as follows.

Checks on ourselves—charged to bookkeepers.

Checks on clearing house banks—charged to clearing house department.

Checks on out of town banks—charged to transit department.

Checks on other banks in town—charged to collection department.

Other items, such as coupons, collections, etc. charged to their respective departments.

Clearing house checks are given first treatment in order to get them in the morning clearing. They are stamped with the bank's indorsement, by a special check indorsing machine, and sorted according to banks drawn on and added to the work of the previous day, now ready for the clearing house exchanges. The letters are stamped

with the date received, the clerk proving the same, and section to which they belong and are sent to the bookkeepers for credit to the respective sending banks

Afternoon Mail.—Mail that arrives too late to have the checks collected through the clearing house is treated as "afternoon mail" and given the same treatment as the night mail; but in this case the large checks which are to go forward immediately are taken out and sent forward to their destination, in order to make an early collection. Checks on the bank itself will be charged up the same day, and other pressing matters promptly attended to. Thus, in an afternoon letter there will be found a check for $10,000 on a far distant bank. It will be taken out of the letter, a slip substituted, and the check sent to the transit department for prompt collection. Banks establish their own rules as to what checks are to be taken out of the late mails, holding the rest over until the next day. In other words, the bank sends forward the same day as received all checks that can possibly be gotten into the day's work, it cannot however, hold up the bookkeeper's proofs indefinitely, and there must be a stopping time. Many of these letters contain checks or other items having special instructions connected therewith. These are carefully noted and complied with promptly. Thus a letter will contain a large check, with instructions to collect and transfer proceeds to account of X. Y. Z. in another bank and advise by wire when this is done. This special request will have the personal attention of some one in the department.

After letters containing checks are proven and posted to the respective accounts they are acknowledged. This is preferably done by postal card, stating "Your favor of the 1st inst with enclosures as stated received." Many banks enclose a return card for this purpose. These acknowledgments should be promptly made and

always made, so that letters which go astray in the mail may be quickly detected and traced.

The acknowledgments are sent out by special clerks to whom are given the original letters after the bookkeepers are through with them

Travelers' Checks.—Inasmuch as this work has to do solely with domestic transactions, the subject of letters of credit and foreign travelers' checks will be treated under Foreign Exchange and kindred subjects by other writers in this series. Domestic travelers' checks properly pertain to domestic banking and their issue is as follows. Some of the large banks and express companies issue travelers' checks through correspondent banks and other agencies. The A. B. A. checks so widely advertised are the authorized checks of the American Bankers Association and are issued through the Bankers Trust Company of New York. They are sold by a large number of banks in all parts of the country. The Bankers Trust Company sends to each bank a supply of blank checks in denominations of $10, $20, $50 and $100, with a record of their numbers. The checks are dated, signed by an officer of the issuing bank, and by the buyer at the time of purchase. The funds are paid to the selling bank, plus a commission of ½ per cent. The selling bank remits the face value to the Bankers Trust Company with advice of the buyer and the numbers sold. The buyer may then take the checks to any bank, hotel, etc., and have them cashed or accepted in lieu of money. They must be countersigned before the one accepting them with the same signature as made at their purchase and are then made payable to the party cashing them.

Travelers' checks are in substance a form of money that is most desirable to use in traveling. They are good anywhere and are safe as long as they are in their

original state. The protection lies in the fact that they must be completed in the presence of the one advancing funds against them and are used in large volume everywhere.

COMMERCIAL BANK

[illegible]

19 .

Dear Sir

We enclose herewith { paid / unpaid

Check of ..

Note of

Reason Checked $

DATE
INSUFFICIENT FUNDS
PAYMENT STOPPED
SIGNATURE
ENDORSEMENT
MAKER DECEASED
FILLING
NO ACCOUNT
DRAWN AGAINST UNCOLLECTED FUNDS
CHARGED TO YOUR ACCOUNT

COMMERCIAL BANK

FORM 42 —Return item form

Registered Mail Record.—Registered mail should be entered in a registered mail book, recording the date, addressee, contents of package, and date of post office receipt. As receipted cards are returned they are entered against the item, thus giving a control over registered mail. Any shipment not promptly receipted for should be followed. It is not enough to hold the

post office slip for the sending, the addressee's receipt is equally important. Any losses in the mails will then be quickly ascertained.

Return Items Book.—Banks return to their customers a great many instruments, such as unpaid checks, coupons, paid notes, drafts, etc. All such items are

VOUCHERS RETURNED

COMMERCIAL BANK

New York, N.Y.______________192__

____

____

Dear Sir.

We enclose herewith statement with vouchers from________ to________

COMMERCIAL BANK

FORM 43 —Record of vouchers returned

entered in a *return items book*, which is best in a duplicate form, one copy going with the item the other remaining in the book. The reason for the return is checked. By this record all such returned items are accounted for and it frequently becomes necessary to prove that such return has been made.

Delivery of Vouchers.—Where vouchers are delivered to customers in the statement system it is customary to require an acknowledgment slip to be returned for audit purposes. As a preliminary to this a *voucher returned record* may be kept which lists all vouchers sent out by mail, which accounts for their delivery to the post office, to be subsequently followed by the receipt from the customer. Delivery of statements over the counter will be immediately receipted for. It fre-

quently becomes necessary to prove that vouchers were returned to a customer who claims he never received them. The returned voucher record comes into play in such cases as a medium of tracing.

Safe Deposit Records.—Where the safe deposit vaults are conducted as part of the bank's operations, the records should be the same as for a well-organized safe deposit company. The chief risk in this respect is unwarranted entry—that is, the entry into a box by one who has no right to enter; and if anything of value should be taken by the one entering the box without such right, the bank would undoubtedly be liable to the owner of the box. Possession of the key is by no means warrant for entering a box The records that are commonly used to safeguard box owners are:

1. *The Contract of Rental.*—This is a card with the contract governing the relationship established between the parties. This is signed by the renter who may take the box jointly with another, or deputize another to enter. It gives the box number, rental per year, the term of the rental, code word used as identification, etc.

2. *The Rental Receipt.*—This may have more detailed information regarding the contract between the parties, and inasmuch as this goes to the customer, the rental agreement is better expressed in this instrument than on the card. The customer cannot then claim ignorance of the rental agreement.

3. *The Expiration Record.*—This is a record of expiring rents, and kept chronologically. Notices are sent out monthly to those whose rents are to expire during a given period.

4. *Record of Entries.*—There should be a record of each entry into the boxes. This should be kept alphabetically or numerically and in a form convenient for the customer to sign. At each entry into the box the customer must

sign with the date and time of entry. Customers not known to the attendant should of course be identified, either by the code word or some other method. The signature may be taken on the entry record as sample for future comparison.

The entry record is useful for the purpose of restoring articles and papers, securities, etc., left behind in the booths by careless box owners, and is invaluable as a record of who entered a box and when.

Customers' Check Books.—From time immemorial it has been the custom for banks to furnish their customers with check books gratis, and in many cases to print the name on the end and to number the checks. This practice is costly, and these charges constitute one of the heaviest items in the stationery account. With the growing use of safety and specially made paper with the bank's monogram or other device worked into the paper by various methods, the cost of check books has mounted up. Comparatively few banks are now using commonplace paper and take pride in the quality of their checks. These checks should be purchased in large quantities for the sake of economy. The expense can be prorated over the period if desired. Check books without names and numbers are made up in bulk; but other checks must be imprinted to order. The stationer keeps the checks in stock ready to print the name, number the checks and stubs and bind into books. Checks engraved on the best safety paper now cost about $3.50 per thousand and the making of a book of 500 checks, with name and numbers, with binding $2 to $3 additional.

The Bank's Stationery.—The stock room of a large bank contains a valuable and costly lot of printed matter. Banks are large users of stationery and must constantly keep watch over their supplies, lest they fall short of a necessary form at a critical time. To this end a running

inventory is kept of all forms on hand, by card index The forms are numbered for identification purposes and may be grouped by names or preferably by numbers. This number appears in fine print on each form, and often with the quantity purchased and the date. A card index should be kept for each form. To it are carried the amount of stock on hand, with cost of the same, date of order and printer. As supplies are taken out on requisition, they are taken off the amount, and as new supplies are received they are charged. By this process a bank can tell how many of each form there are in stock, and orders may be placed in advance in time to keep the supply adequate. Without a running inventory, a bank must depend upon the observation of the stationery clerk to check supplies that are running low, which is not a satisfactory method of keeping supplies on hand in sufficient quantities to meet the daily needs.

A sample of each form used should be kept in an index file which has a complete set of all forms used by the bank.

Yearly Reports to Directors.—In summarizing the result of the year's operations for the board the following will be found of interest:

1. Income of the bank, classified.
2. Expenses, classified. Miscellaneous expenses grouped and itemized.
3. Profit and loss statement for the year.
4. Charge-offs in detail.
5. Other charges, such as interest, taxes, etc.
6. Volume of deposits and withdrawals.
7. Number of deposits received (all departments)
8. Number of checks paid (all departments).
9. Mediums used in advertising and the amount expended on each.

10. Estimated income for the ensuing year, with estimated charges.

Library and Statistical Work.—All banks should have a bank library even though the collection of books be limited. There should be in the bank a standard work covering each phase of banking, legal and practical It should be possible to answer any reasonable question regarding banking matters from the books in the bank collection. The statute law of the state and the National Banking Act and Federal Reserve Act should be on file and brought up to date. These laws should be familiar to every bank man. There should also be the "Legal Opinions of the Counsel for the American Bankers' Association" which cover practically every subject that can arise in the day's work. There should be standard works on banking practice, economics, law, taxation, corporations, etc. The standard magazines and daily financial papers should be subscribed for and placed where the force can use them. Where the bank is large enough there should be a librarian and statistician who assembles financial information, classifies clippings, articles, etc., so that current information on any given subject may be quickly obtained The extent to which the statistical matter is gathered depends upon the bank. The large banks will have extensive files, while the smaller ones will not collect such first hand data at all.

A great many banks are now publishing a monthly or semi-monthly financial review of current conditions. This may be prepared under the direction of the librarian or statistician, who will cover the subjects which the bank reviews in its periodical publication. The forecast and expression of comment on conditions may be over the name of an officer who may or may not collate the information that supports the conclusions. The library

is exceedingly useful to those officers who make addresses and write papers for publication.

Addressing Lists.—Every well-organized bank has a mailing list. This is made up of its own customers and in addition such other names as it may decide are desirable as prospects. In the larger banks this will include a list of all business houses in the city, or within its territory, classified. In smaller places the list should include such names as will give the bank access to every home and business place. These names are taken from telephone books, directories, voting lists (which are accurate), list of electric light and gas consumers, etc. The bank's list is used to send out announcements of interest to the bank's customers only. This includes holiday greetings and matters of concern only to the bank's present customers. The other lists are used to send out general advertising, booklets, statements, announcements, etc.

The names are frequently revised and returned letters indicate a change of address that should be altered or removed from the files. These lists are made up in such form as to be used in addressing machines, so that the labor of addressing is reduced to a minimum. As fast as results are achieved by bringing in new customers the name is taken out of the general list and placed in the bank's own customers' list.

The Central File.—More and more banks are coming to realize the value of a central file. This file includes the names of all customers of the bank and indicates what services of the bank the customer is using Inasmuch as most banks are now operating savings departments, safe deposit vaults, investment and trust departments in addition to the regular checking department, the central file is valuable for use in soliciting the customer for other departments of the bank. The bank has not exhausted its possibilities with its own people until all are using

such departments of the bank as meet their respective needs. Thus the trust department may be built up from within the bank, by calling frequent attention to the services of this department. Likewise the other departments of the bank. Once the central file is begun, it is merely a matter of attention to keep it up to date. This file is useful also in deciding upon the payment of short checks. A customer might be overdrawn in one account, or department, and be covered by funds in another. The customer who knows he has funds in the bank in two or three accounts assumes that the bank shall know as much about his accounts as he; and while it cannot know these ramifications exactly, the central file will be a great help If, for instance, the customer is short in the checking account, reference to the central file will show whether or not he has other accounts, or is using other departments that may have sufficient balances to cover the overdraft. The central file is useful also in credit references, since its information is exact and leaves nothing to memory.

Closed Account Record.—It is as important to know what accounts are closed out as it is to know what accounts are opened. To this end a closed out record should be kept giving the names of all closed accounts, with the amount at the time of closing. The reason if known should be placed on the card. A letter of regret should be sent out and it should inquire if any part of the bank's service has been faulty or unsatisfactory Frequently the answer will be highly commendatory and therefore most pleasing, and occasionally a real fault will be found which can be corrected. As soon as accounts are closed they are removed from the current mailing list of customers and taken from the central file and indices. They should be reserved for special effort to win back, unless the customer is leaving the city

permanently, or for other reasons it is impractical to consider him a possibility again.

Analysis of Customers' Accounts.[1]—Much has been written about systems or methods of analyzing customers' accounts. Nearly all have merit Some, however, are too complex for the smaller banks to use—requiring too much work in determining the various factors and in applying them to the individual accounts. When we read of a new plan for doing a certain kind of work, we naturally wish to know how it will be applied, how long it will take to do it, what the results will be, and whether these results will warrant the time and effort spent to obtain them. I shall endeavor to describe an analysis system which can be used profitably and easily by the smaller banks as well as the larger ones. I shall also show the practical application of it and, what is perhaps most important, the results obtained

The institution with which I am connected commenced analyzing its commercial department accounts in 1911, feeling that only by an analysis could losses be detected and prevented. In addition to this function, the analysis of accounts has been a valuable aid in extending credit, by giving us not only the comparative value of each account, but an accurate history of each account over a lengthy period. For instance. Does the balance fluctuate more than we think it should? Does the average balance compare favorably or not with the average loans, and is the activity increasing or diminishing? Are we making or losing money on the account, and how much?

The method of analysis which we have been using since 1919 is explained in a little booklet issued by the

[1] Address before Philadelphia Chapter, American Institute of Banking, by Lewis Van Court, Assistant Treasurer of the Central Trust and Savings Company of Philadelphia

Federal Reserve Bank of New York, entitled, "Analysis of Depositors' Accounts—Short Method." It is this method, its use, and the results obtained from its use, that I wish to explain.

Four General Factors.—In order to apply this method there are four general factors which must be considered and ascertained:

1. The amount of the depositors' balance that can be loaned or invested.

2. The amount of income that such a balance when loaned or invested produces at the average net rate on loans and investments.

3. The amount of disbursements directly traceable to each account.

4. The amount of the bank's general expense which should be equitably apportioned to each account.

I shall now take up each of these factors in order and show just what they inlcude and how we put them into operation in our bank

1. The amount of balance that can be loaned or invested.—We get this figure from our interest slips or analysis slips, as we prefer to call them. Interest is computed quarterly and so we make our analysis period coincide. These slips provide space for three months' credit balances and also allow for three month's debit balances or totals in transit. Most banks, in figuring outstandings, use a four or more column form and distribute the amounts between the different columns according to days outstanding However, we use Burrough's calculators, which find the total outstanding for one day much more quickly, just as accurately, and with considerable saving of stationery. The average daily outstanding deducted from the average daily ledger balance, of course, leaves us the net or loanable balance.

2. Amount of income that such a balance when loaned or invested produces at the average net rate on loans and investments.—The point here is to get the average net rate, and as our books are closed quarterly, we take the business of a quarter as a basis. Our books showed what our gross income for this period was, and it was easy enough to average our total assets for the same period and find that we earned an average annual rate of 4.408 per cent on all assets, or 1.102 per cent for the quarter. (The income mentioned does not include, of course, that earned by our title, trust and real estate department.) This might seem like a low rate, but you must bear in mind that this is on all assets, which included items such as cash on hand, accrued interest receivable, and so forth. The annual rate earned on *earning* assets was 4.648 per cent and would have been better, except for the fact that, as we do a very active commercial business and as our savings deposits are considered by us as demand deposits, we carry a larger reserve than legally required. Cash on hand and in banks for this quarter averaged 16.1 per cent of our total deposits—both savings and commercial—so that practically one-sixth of our deposits or one-seventh of our assets produced little or nothing, comparatively speaking. This fact brought the annual rate earned on *earning* assets to 4.648 per cent and to 4.408 per cent on all assets. This 4.4 per cent is our second factor.

While not pertinent to the subject it might be said that we went further on this schedule and averaged our liabilities for the same period, listed the direct expense of each item, and added general expenses and taxes These totaled our entire expenses; and, of course, when we deducted these expenses from the sum of our gross income, as mentioned previously, plus income from title, trust and real estate department, we ascertained our net

earnings according to our books. We did this to satisfy ourselves that subsequent calculations based on certain of these figures would be at least started correctly.

3. The amounts of all disbursements directly traceable to each account —This will include such items as cost of special check book, collections, and interest on the account.

4. The amount of the bank's general expense which should be equitably apportioned to each account.—This is not so easy. If you have a large classification of expense accounts and few departments to distribute the expense over, or if each department keeps its own expense records, it is somewhat simpler. We have the following principal departments over which we distributed our total expenses: Commercial, savings, transit, loans, title, trust and real estate, safe deposit, and building.

Salaries of employees, excluding officers, were distributed among the different departments in which such employees were engaged or if their time was spent in more than one department, it was apportioned on a time basis. One-half the salaries of all officers was charged to the loan department, as it was assumed that 50 per cent of their time was spent in credit work, passing on loans, calling on credit applicants, and other work in connection with the making of loans. This excludes, of course, title and trust officers, their salaries being charged to that department. The remaining one-half of salaries of officers was proportioned over the other departments on the basis of salaries paid employees in each particular department The salaries of employees and officers charged to each department were then totaled The distribution, thus far, we felt to be accurate. The remaining expense accounts had to be arbitrarily distributed, but as they totaled less than one-half the salary accounts, we felt our basis of apportionment fair

and sufficiently accurate. For instance, miscellaneous general expense was distributed on a basis of all salaries paid, and telephone charges were apportioned in the same way. Light, coal, and repairs accounts were charged to building. Other expense accounts were apportioned to the departments solely affected, or if several departments were concerned, then on the basis of all salaries paid these different departments With this distribution completed, we had the total general expense of each department.

Included in the departments which have been mentioned were the transit and loan departments. The total expense of these departments was apportioned on the following basis: Transit department expense was charged to commercial and savings departments in proportion to the number of items handled for each of these departments. Of course, the transit department also handled items from the loan and collection departments, but these were comparatively few and did not need to be considered. It might be mentioned here that a count was made of all items, both incoming and outgoing, passing through both commercial and savings departments for one week. This will be referred to later. Loan department expense was distributed to commercial department, savings department, and capital and surplus account. This apportionment was on the basis of average funds invested by the loan department for each of these divisions of the business. The amount of the transit department and loan department expense apportioned to the commercial department, together with general expenses of that department, equaled the analysis expense.

We went a little further on this schedule than the analysis method required because we wished to find the net profit or loss of each department. To the analysis

expense of the commercial department we added interest paid on these accounts, which gave total expenses The 4.4 per cent annual rate, or 1.1 per cent for the quarter, was applied to our average commercial deposits for this period, and this showed our gross earnings, the difference, of course, between such earnings and expenses being net profit. The gross earnings of our savings department and capital and surplus division were determined in the same manner. To the cost of loan department apportioned to capital and surplus was added dividends paid on our stock; state and federal capital stock taxes might have been added, but they were charged elsewhere. The result of this schedule showed the net profit or loss of each department or division of our business.

I shall now go back to the analysis expense of our commercial department To distribute this amount fairly to each commercial department account it must be divided according to (*a*) Activity of accounts, (*b*) size of accounts, and (*c*) number of accounts. In this distribution no exact basis is possible—for instance, salaries of employees were distributed two-thirds to activity, one-third to number, nothing to size. Advertising went to number, transit department cost to activity alone, and loan department cost to size alone All our other commercial department expenses being distributed and totaled, we then had our total activity cost, size cost, and number cost. These costs or expenses are now apportioned to each account as follows:

(*a*) Activity Cost.—This is distributed to the individual account according to the number of items handled, whether incoming or outgoing. As mentioned before, we counted for one week the number of deposits and incoming checks, and also the different kinds of outgoing checks; we found a total of 33,202 items, or an

average for each day of the six of 5,534 for the commercial department. The seventy-nine business days of the quarter we presumed would average about the same and therefore multiplied our daily average by seventy-nine and arrived at a total of 437,186 items. The activity expense was $13,836.07—making the cost .0317 per item.

(*b*) Size Cost.—This is distributed to the account according to the amount of balance carried. Our commercial deposits averaged $6,399,000 and our size expense was $4,842.98. Size cost was therefore .757 per thousand for three months.

(*c*) Number Cost.—This is equally divided over the number of accounts, irrespective of activity or size We had 5,134 accounts in our commercial department and the number expense was $7,668 20. Number cost was therefore $1.49 for three months.

Application of Factors.—We have now covered the four general factors to be considered and also the three costs—activity, size and number—which constitute the fourth general factor, so let us apply them.

From our interest or analysis slips we get the average ledger balance for three months. They also give us the average daily outstanding for the same period. The difference is, of course, the net or loanable balance On this balance our gross income is figured at 1.1 per cent. This is, of course, the quarterly rate.

The next three items on our analysis card are: (1) "Indebtedness—Double," (2) "Indebtedness—Single," and (3) "Under Required Balance." These are not considered in the method described in the booklet referred to and so they have not been mentioned until now. Our loan department averages from its loan credit ledgers the two classes of indebtedness; we consider that a net balance equal to 20 per cent of the single name indebtedness should be maintained. Some

banks, we understand, base the required balance on both single and double, others on single, double and collateral, and still others on the credit line, whether used or not. How they correct an "under required balance" we do not know. This brings us to the "Under Required Balance" item, which is the amount of the difference between the net balance and 20 per cent of the average single name indebtedness. If the balance is less than 20 per cent, we charge as an expense of the account 1.1 per cent of this under required balance The rate, you will notice, is the same as applied to net balances

The next two items are "Activity—Outgoing" and "Activity—Incoming." The number of each of these is obtained from our interest slips, where they are entered daily from the deposit slips and ledgers by our bookkeepers. The expense of these items, or activity cost, is figured at .031 an item

The next item is "Size Cost" of $ 75 per thousand of net loanable balance. Next is "Number Cost" of $1.49, applied equally to all accounts regardless of activity or size. Then follow some spaces for disbursements directly traceable to the account, such as special check book costs, collection costs, interest, and so forth.

Of course, the difference between the total of these costs or expenses and gross income represents our profit or loss on each account. Our analysis card provides sufficient space on one side for sixteen analysis quarters or four years and, of course, gives a very complete idea of an account over a lengthy period. The reverse side of the analysis card provides spaces for financial statements and miscellaneous information about the account.

It took two days to prepare our figures and arrive at the factors which we use. It takes not more than 200

hours every three months to analyze over 2,000 accounts. This figure is liberal, because last March it was practically all done in the evenings and a record was kept of the time. Our last analysis quarter ended March 25, and all the work was finished by March 29.

Results Obtained.—Before giving you the results, it should be explained that we have approximately 5,000 accounts in our commercial department; 1,800 of these are inactive and are not analyzed, because there is practically no expense in handling this class of accounts. Of the 3,200 active accounts, 2,388 were analyzed last quarter and 881 accounts were charged with the expense of handling.

There were other accounts than those 881 which showed losses, but which were not charged, because the persons who had them did business with some other department or because they were connected in some way with other accounts. Approximately one out of every five accounts in our commercial department shows a loss under analysis. However, the total balances of these 881 loss accounts amounted to only $381,573, or less than 6 per cent of our commercial deposits. We have also found that an analysis charge prompts the customer to increase his balance if possible. The average balances of those accounts charged in a recent quarter totaled $367,228, whereas the average balances of the same accounts three months later totaled $399,003, an increase of $31,775, or nearly 9 per cent.

The loss, which we in this way recovered from these 881 customers for the three months, was $9,257.75. For the year ending with the quarter to Dec. 25, 1921, we analyzed on an average 2,215 accounts each quarter, of which a quarterly average of 763 showed losses averaging $7,666.22, or a total of $30,664.88 for the year.

Simple Method of Analyzing Accounts.[1]—Every account, because it shows a credit balance, is not conclusively to be presumed profitable. It may yield revenue, but not sufficient to satisfy the expense of handling. Or, it may not only fail to produce a gross income, but occasion an actual loss. So, even among bank accounts, all that glitters is not gold.

Each year a greater number of large banks recognize the desirability of having more definite facts concerning the value of various customers' relationships, and, with that purpose in view, organize analysis departments. But among smaller institutions, the practice is less general It is to the smaller bank, particularly, that this discussion is directed. The promiscuous closing of accounts which, under analysis, do not appear satisfactory is not necessary. There are many occasions when such a course would be injurious to a small institution. But if a customer's business is unprofitable, the bank at least should not be ignorant of the fact. Neither is it necessary for smaller banks to operate an elaborate system of getting information. The short form of analysis herein described requires neither.

The Small Account Problem —One of the first things a banker will find upon scrutinizing his business is that he has on his books a considerable number of small accounts with balances insignificant when compared with the expense of handling. Almost any active account under one hundred, or even two hundred dollars, may be included in this group.

To large banks small accounts present a grave problem, they build up clerical expenses without materially increasing gross income. Most city banks either refuse to carry them, or protect themselves against loss by

[1] DALE GRAHAM, Mississippi Valley Trust Co , St Louis, in the *Banker and Financier*.

assessing a service charge of from fifty cents to two dollars per month when an account falls below a certain minimum and reaches a certain point of activity. From the customer's standpoint such a charge is entirely just, as there appears no logical reason why the bank should furnish him a passbook, checks, and deposit slips, do his

ANALYSIS OF ACCOUNT

Name EXCELSIOR MANUFACTURING COMPANY Month August 26 to September 25 1921

	One Day	2 Days	4 Days	Book Balances
26	421	86	136	1437
27	317	102	511	1006
28				1006
29	218		622	1250
30	90	175	317	1142
31	120		150	331
1	425	500	620	872
2	311	25	916	925
3			533	916
4				916
5	960	136	429	1140
6				325
7	130	350		400
8			500	826
9	222	75	372	215
10	200		111	208
11				208
12	816		203	416
13	20	213	196	185
14				93
15	1150			106
16	211	186	58	405
17			120	302
18				302
19	316			211
20	232			117
21	50	423	316	503
22			125	496
23	152	385		318
24	225	45	316	348
25				348
	6586	2701	6551	17273

SUMMARY

Total of Daily Balances (Divide by days in month) 31) $ 17273-

AVERAGE DAILY BALANCE $ 557-

One-day Items $ 6586

2 X Two-day Items $ 5402

4 X Four-day Items $ 26204

Float One-day Basis (Divide by days in month) 31) $ 38192

AVERAGE DAILY FLOAT $ 1232

NET ~~BALANCE~~ OVERDRAFT $ 675

Add ~~Less~~ 15 % Reserves $ 84

~~LOANABLE~~ DEFICIT BALANCE $ 759

~~GAIN~~ LOSS for month at 6 % $ 379

Printing Checks 9-5-21 $ 450

Need for Pay Roll 10 % [illegible] $ 198

Total Loss $ 1027

$

Have 10 % loan 6% due 10-1-21

Form 44 —Simple account analysis form

bookkeeping for him, and afford him the convenience of a checking account without being reimbursed in some form or other for actual expenses, any more than the butcher should sell him meat for less than cost.

The large bank can afford to deal rigidly with small customers, for, having attained considerable size and a certain degree of independence, it can serve its own interests best by catering more exclusively to larger business. But the smaller institution is less often able to handle such accounts arbitrarily.

The small bank which operates a savings or safe deposit department, or does an insurance or investment business, may occasionally place a small customer's business relations on a paying basis by constant cultivation. This often is the only possible procedure. Turning his attention from small accounts to larger ones, the banker may be surprised to learn that a few of those he valued most highly are not so profitable as he thought. It is in seeking out such accounts that an analysis is of great service, for in many instances the causes which make the large account unprofitable may, by tactful methods, be removed. Look out for the customer who:

1. Deposits checks which require from one to four or more days for collection, and checks against the balance thus built up before the proceeds are available.
2. Requires the bank to keep cash on hand to meet his payroll needs.
3. Receives from the bank expensive check books—often printed for his individual use—or great numbers of pay roll checks.
4. Asks the bank to remain open after business hours and keep additional currency on hand to cash pay checks for his employees.
5. Deposits currency and sends large checks out of town, thereby necessitating continual shipments of cash on the part of the bank to restore balances with correspondents or the Federal reserve bank.
6. Deposits numerous sight drafts on individuals in other cities, which require separate mailing and incur considerable postage and stationery expense.
7. Discounts his customers' notes with the bank.
8. Continually stops payment on his checks, laying the bank liable in case of inadvertence on the part of a bookkeeper.

The above do not, with the exception of checking against uncollected funds, necessarily constitute things a customer shouldn't do, nor is it intended to imply that they invariably result in losses to the bank But they are services which the customer should adequately pay for with a respectable balance, the bank has a right to expect and demand that he pay for them.

A form such as illustrated, is all that is needed for a simple and comparatively accurate analysis of an account. This form provides lines for the principal items and allows space for additional calculations and corollary remarks.

Book Balance vs. Float.—The manufacturer with an out-of-town market, the grocer, the insurance agent, the wholesale produce company, the merchant in a neighboring town—in fact, any customers who make frequent deposits of checks—may be drawing against their uncollected items, or float In determining whether or not this is the case the first step is to provide a schedule of time outstanding which will be applicable to items on various points. Checks on other banks in the same town, when deposited too late for clearings, should be subject to a one-day deduction; deductions for out-of-town items should be based on the Federal reserve bank's schedule of deferred availability (plus one day, transit time to Federal reserve city) if the analyzing bank is a member, or the actual time required through the agencies employed, if the bank is not.

When the deposit of a customer whose account is under analysis is received, the teller, or whoever accepts it, may mark with his pencil opposite each item as listed, the number of days it should be outstanding according to the schedule. For convenience small items of the general run may be included arbitrarily in the one-, two-, and four-day groups (whichever is most correct) and posted

in the proper columns in the schedule. Larger items can be posted into the two columns which together equal the proper number of days.

The necessary daily posting having been done, the columns should be totaled at the end of the month and the amounts carried into the summary and reduced to a one-day basis as illustrated. Likewise, the book balances shown at the close of each day's business should be posted into the column provided for the purpose, and, at the close of the month, totaled. Dividing the amounts by the number of days in the month will produce, respectively, the average daily float and the average daily balance The difference between these will be the net balance or the net overdraft.

It will be noticed in the illustration that, over the entire month, the Excelsior Manufacturing Company's float exceeded its balance by six hundred seventy-five dollars. No doubt on some days the overdraft was even greater, but the method of computing net balances daily is so complicated that it will be omitted from this discussion. At any rate, the account is unprofitable

Reserves.—The overdraft shown by the first operation is not, however, the entire deficit. Although fictitious, the book balance of $557 calls for a 7 per cent reserve with the Federal reserve bank, and business requirements necessitate an equal or greater amount in cash and with correspondents. If the analyzing bank is not a member of the Federal Reserve System, the state law provides for a larger reserve. Each institution may determine its true reserve percentage by dividing all its cash on hand and balances with other banks by the total of its demand deposits.

So an additional $84 is added to the deficit, making a total of $759. This, at 6 per cent, would cost the bank $3.79 per month, or represent an annual loss of $45.48.

Miscellaneous Considerations. Pay Roll Accounts.—Any surplus cash which is held to meet the needs of a customer for his pay roll should be given consideration in the analysis, and interest computed at the current rate on the proper amount for the time the money is held. If any shipping expenses are incurred, they, also, should be added.

Stationery.—It should be needless to say that customers who receive considerable quantities of checks, deposit slips, customers' notes, sight drafts, coin wrappers, etc., gratis from the bank should be charged in the analysis for the cost of such supplies. It is not necessary to devise an elaborate system to keep a record of all check books and other stationery given out; only the more important items need be considered.

Accommodation Services—Staying open in the evening to cash pay checks often results in acquiring new savings accounts and is usually worth while, but handling sight drafts, issuing exchange without charge, acting as collection agent, holding securities for safekeeping, and furnishing rooms for stockholders' and directors' meetings are services for which a customer should maintain a commensurate balance.

Activity of Accounts—In this analysis no attention has been paid activity, as in the ordinary small bank it is difficult to so allocate expenses that "per item" figures have much importance. Any bank which cares to do so, however, might count a large customer's checks and charge them up to him in the analysis at a nominal figure, say one cent each. Extreme activity, while it may not occasion additional expense for the bank, may be used as a talking point in convincing a depositor he should carry a larger balance.

The Customer Who Draws Checks in Anticipation of Deposits.—Such a practice, while it may not result in an

immediate actual loss to the bank, is nevertheless a warning that the customer is a dangerous one. From the habit of covering checks the day they are due for presentation often springs wilful manipulation, or "kiting"

Account analysis should prove interesting as well as profitable to the small banker, for it will enable him to know just who his best customers are, and encourage him to cultivate the business of those whose relationships can admit of improvement In the average bank the method outlined above should not require more than a few minutes of a clerk's time daily, and slightly more than an hour at the end of the month.

CHAPTER XVIII

AUDITS AND EXAMINATIONS

The primary purpose of a bank *audit* is to have an internal control of all the operations of the bank. In all banks of considerable size there is an auditor who is charged with this control and who checks the work of the various departments or employees in order to keep the work in a high state of accuracy and to have a continuous control over the assets and liabilities. The auditor verifies what other men have done, and should be able to detect any irregularities before they have become acute. He is a continuous examiner.

The purpose of an *examination* is to appraise and verify all the assets and liabilities at a stated time The examination is periodic; the audit is continuous. The auditing is done by the bank's own officers; the examining is done by a committee of directors, the public authorities and chartered accountants

The bank force knows that their work is being constantly supervised; they also know that examinations will be made, but the exact time is uncertain. There is, therefore, a control from within the bank and a control from without, the result being to keep the bank at all times within the law, and the operations regular, accurate and safe. An auditor should detect any irregularities promptly and check them; while an examination is not so exacting or intensive. Nothing should escape an audit; while irregularities might be overlooked in an examination

The Auditor.—There is in all large banks an auditing department in charge of a head auditor or comptroller He controls the bookkeeping system of the whole bank. Under him are the general bookkeepers who keep the controlling books. Through his hands pass the work of the various departments day by day. He keeps a separate control over them from without as the department head keeps control from within. With a force of assistant auditors he checks the work of each department as it is reported to him. He will pass out the cashier's checks to the various departments and require an accounting for their use. He audits the bills of the bank before and after payment. He signs requisitions for supplies At frequent intervals he will examine each department by his own men, and not only check up their work, but ascertain that the bank has in its possession the various assets as called for by the statement. Thus, he will audit the loans and prove the books of the department to be in agreement with the books of control. He will examine the securities and prove them with the security record. He will examine the securities held for clients and satisfy himself that all are duly in hand or accounted for. In short, he is a continuous supervisor, and more, a continuous auditor, checking, checking and checking, all that the bank does, with no thought in mind other than that the bank employees must account for all they have done. Eternal vigilance is the price of banking safety.

Inasmuch as the auditor must intelligently examine every department of the bank, it follows that he should be familiar with every aspect of bank routine. As a rule he is one who has passed through the various departments of the bank and become familiar with their workings He must therefore have an accounting mind, and be able to analyze, detect, and follow clues to conclusions.

He is responsible for the detection of frauds imposed upon the bank, errors in the work and irregularities which may grow into serious proportions. The duties of the auditor may be divided into two general classes: (*a*) Those of daily audit, and (*b*) those of periodical summation, such as in reports to supervising officers, the public and the board of directors. Included in division (*a*) are the periodical audits of the various departments. More specifically the auditor has charge of the following verifications:

Verification of income.
Reconcilements with other banks
Reconcilements with customers.
Adjustment of errors in the books
Compilation of reports as called for.
Statistical information concerning the bank's operations.
Audit of all cashier's checks and like instruments obligating the bank as drawer or acceptor
Overdrafts.
Checking of messages in code.
Checking of currency shipments
Verification of certificates of deposit issued
Verification of certified checks.
Verification of letters of credit issued and banker's acceptances made.
Filing of the bank's old records and their ultimate disposition.
Audit of all expenses incurred
Audit of bills paid.
Requisitions for supplies
Verification of all deposit liabilities

Parts of the above may be delegated to those outside the auditor's department, but in the final analysis the

auditor must pass upon the transactions as they go through the bank.

Verification of Income.—The verification of income is accomplished by checking the amounts received as discount into the general ledger or journal sheets. It is obvious that if a customer is charged a certain amount as discount on a note, if the amount is shown on the daily receipts, and is carried to the income account, the bank has received the funds. For a close audit the discount on all notes should be checked in this manner. The interest on loans, securities, mortgages, etc., are likewise checked into the journal and thence into the ledger. The fact that an account is credited with interest received by no means makes it certain that the bank has received the amount. It should be checked *back* from the ledger account into income, through the cash receipts, or vice versa.

The principle of accounting to be here observed is that a bank may be defrauded by the *withholding* of a cash receipt and at the same time credit the debtor's account as having paid it. The bank should receive what it earns and *what it earns must pass into the assets*

Some banks at the begining of a period charge up what the bank will earn during the coming period on bonds, mortgages, etc., and require the collecting officers to account for the amount as receipts; but only a large abstraction would respond to this audit and the better way is to check the individual items.

Reconcilements with Other Banks.—In dealing with other banks, monthly statements are rendered. These are checked by the correspondent banks and verification is returned. On account of the frequency of transactions on such accounts, there will always be checks outstanding that must be taken into account, in the same manner as outstanding checks are accounted for in balancing a

private check book with the bank's statement or balanced pass book. Correspondent banks draw checks in large numbers, and such accounts are most active. There are also daily credits to the correspondents' accounts arising from such transactions as: Notes, acceptances, etc., collected and credited, coupons collected and credited, maturing securities, loans called for correspondent's account, interest on daily balances, together with the daily remittances of checks for credit and collection. As charges there will be returned items, loans made for correspondent's account, protest fees, exchange, letters of credit issued, foreign exchange issued, interest on loans made to the bank, currency shipments, and other charges.

Daily debit and credit tickets will be sent by mail, from and to the bank, and the monthly reconcilements will show up any missing entries on either side.

Customer's Reconcilements.—Whether the bank be large or small, it is essential that the periodical statements rendered to customers be reconciled. Where the pass book is balanced, the balance as shown by the book is compared with the ledger and initialed by the auditor; or, a slip may be enclosed with the book and vouchers, to be signed and returned by the customer. A record of these returns is kept so that should any question subsequently arise the bank will have some proof of the reconciliation. Where the statement system is used, there will be a form enclosed with the statement, or a part thereof, to be signed by the customer and returned. In this he acknowledges the receipt of the vouchers and certifies to the correctness of the balance. A careful checking of these returns should be made so that the bank may have in its records evidence of having returned the vouchers and that they have been examined and found correct up to a certain date If the returns are

not forthcoming promptly, letters are sent out requesting attention to the reconcilement Any errors reported are adjusted through debit or credit tickets properly initialed. It is important that the one signing the verification be authorized to do so, otherwise the bank may be liable to the principal on the ground that the reconcilement was unauthorized and did not bind him.

In many cases where the bank account is the medium through which a fraud is perpetrated against the bank and the bank's depositor, the guilty one reconciles the bank statement and certifies to its correctness. Caution suggests that the verification should be over the signature of the principal and not his agent or servant. The usual rule is that if no errors are reported within a given period the account is considered as correct; and in some jurisdictions any claim against a bank as for forgery or alteration must be made within a given time or the right of redress against the bank is lost.

The rule in New York is that a claim against a bank for raised, forged or otherwise irregular payments must be made within a year from the date of return of vouchers, otherwise the bank is not liable (Negotiable Instruments Law, Sec. 326.)

Adjustments.—In all banks there are many adjustments with customers. These arise by virtue of errors for and against the bank, "blind" checks, errors in posting, lost vouchers, disputed charges, protest fees refunded, checks lost in transit, etc. Banks do not quarrel with their customers and generally give them the benefit of the doubt. In some cases there is no proof as to who was in error. For instance, a bank in New York reported to its correspondent that a package of money was short. It consisted of soiled bills. There was no proof that the particular package came from the bank in question, except that it deposited a large amount

on that date in mutilated and soiled bills. The correspondent bank naturally refused to accept the proof, as it was not conclusive. The auditor would, in such a case, make an investigation and authorize an adjustment charge. Many small matters must be adjusted daily through the books, not the least being overs and shorts in the cash. Protest fees are frequently the cause of much complaint on the part of customers, and banks frequently absorb these fees rather than offend a client. Interest adjustments constitute a frequent use of the adjustment account.

Cashier's Checks.—Cashier's checks are used in large numbers. They are issued in various departments and for various purposes. It follows that they must be signed by different officers if the work is to move rapidly. Each officer authorized to sign is given a book or package of such blanks and the department is often designated by a letter preceding the number. The stubs constitute the charge tickets and these are turned in to the bookkeeper for proper entry. As the checks are returned for payment they are checked against the stubs for correctness. Each officer is charged with the numbers allotted to him, and upon an audit the unused checks must be in hand.

Certified Checks.—The bank's obligation on certified checks is examined at frequent intervals, and the outstanding certified checks as shown by the certification book must tally with the general ledger.

Certificates of Balance.—On public deposits and also those of certain concerns, a monthly certificate of balance is required. This is also the case where an examination is being made of a firm's books by an accountant. Such verifications are made up in the proper department and checked by the auditor before sending out the letters.

Reports.—Reports are frequently required in banks. These requests come from the supervising authorities, the clearing house, Federal reserve bank, etc. Such reports are regular and special. The regular reports are made upon call and the special reports, weekly, monthly

, 19

The balance in this bank to the credit of

at the close of business this

day was $

Very truly yours,

COMMERCIAL BANK

FORM 45.—Certificate of balance

or upon call. The special reports cover loans, average reserve, deposits, etc., for compilation purposes and for publishing in daily press.

Code Messages.—Banks receive many messages by cable and telegraph in code. Such messages involve the payment of money, extension of credit, advices and general information. It is essential that they be correctly coded, both in receiving and sending. In many banks a code department is operated which verifies all incoming and outgoing messages in code.

Purchase and Sale of Securities.—In purchasing and selling securities the prices paid or the funds received are checked against advices from the securities department as to the terms of purchase or sale. The invoices are checked for computation of interest and bond prices, when the transaction is based upon income rate.

Safeguarding Securities Held for Clients.—To put into successful operation a system for safeguarding receipt and delivery of securities, it is necessary to operate a control through the auditing department This is established by an examination and check to the security or investment ledgers, and a balance taken of the aggregate amount of securities.

The securities will then move through the operation of "Received" and "Delivered" tickets to be used in triplicate form and numbered, a space being provided for the signatures on the original of the person posting to the account on the security or investment ledger, and on the first carbon, or vault ticket, the signatures of the vault custodian and the person in charge of depositing or withdrawing securities, the third copy being used for posting entries into subsidiary records

The form of security or investment ledger to be used should provide for debit, credit and balance columns. On all securities received the entries should be posted to the credit column. When distributions, sales, etc., are made the entries should be made in the debit column. The balance on hand of each separate item on the account should be carried in the balance column and this balance should be altered whenever there is a change in the position of the respective securities carried in the accounts.

The balance column should be footed and the footings altered with each transaction so that if in the respective accounts the totals were aggregated at the close of the day's business the result would reflect the total balances, and the amount agree with the balance of auditor's control account.

As the securities or investment ledgers will show the amount of securities held, the installation of a master index, showing the securities and what customers

own them, and which works in opposition to the securities or investment ledgers, being posted, proved and balanced with controlling account each day, is of great value in locating any certain securities in the various accounts.

When a list of securities has been received a copy of the list is retained by the auditing department to be compared with the vault ticket depositing securities in the vault. The securities are passed on to the securities department where they are examined and entered on securities received tickets in detail. · The original, or bookkeeper's ticket, is routed to the clerk who enters it on the security ledger, signs and deposits it in the auditor's lock box.

The first carbon of the vault ticket accompanies the securities to the vault where they are signed in by the vault custodian and the person in charge of depositing them. This vault ticket is also deposited in the auditor's lock box in the vault department. They are collected each day by the auditor, who sees that he receives a completed set of tickets.

When securities are received under letters of attorney and deeds of trust, a carbon of the list of securities so received, properly signed by the receiving official of the bank is delivered to the auditor for the purpose of verification, with the securities received ticket.

When securities are purchased for accounts of trusts and not received until later, in order that the security or investment ledgers may reflect the correct balance of securities at all times, the securities tickets are made at the same time as the order for the check. The original is passed on to the bookkeeper for entry on security or investment ledgers, but as there are no securities to accompany it, the vault ticket is placed in the respective trust envelope and held there until the actual security is received. The auditor,

lacking the vault ticket, will follow the transaction daily until the securities are received, at which time the vault ticket will be signed and deposited in the lock box, thus completing the open transaction in the auditing department.

Securities removed from the vault for permanent delivery are entered on securities delivered tickets and routed the same as the securities received tickets, except they are signed out by the vault custodian and the person authorized to withdraw them.

Where securities are sold the auditor checks the entry in the cash book against the delivery ticket, and in case of distribution, a list of the securities is sent out for verification, to be returned over the signature of the person receiving them, in special auditor's envelopes.

When the day's tickets of securities received and delivered are collected by the auditor, a settlement is made against his controlling account, and by comparison with the bookkeeper, he proves the security of investment ledgers to be in agreement with the auditor's control each day.

In the case of withdrawal of securities for transfer or other temporary purposes a temporary withdrawal ticket takes the place of a permanent withdrawal ticket, and does not require a book entry. This is in duplicate the original advising the auditor of the transaction, who verifies by correspondence the proper delivery, the carbon, or vault ticket, being held in the place of the securities until they are again lodged in the vault, when it is released and completes the transaction in the auditor's binder. This ticket also provides for signatures for withdrawal and for redeposit in the vault

It is extremely important that the securities department where the securities are lodged preparatory to placing them in the vault, should be caged in and kept

entirely apart from the cash and records of the department and only entered by those in charge [1]

Where the securities are in the form of coupon bonds, the coupons are cut as they fall due, the income tax blanks filled out by the bank, and collected and credited with advice to the owner.

Securities taken out from the holdings for any purpose should have proper withdrawal tickets substituted for the securities and the withdrawn securities are sometimes entered in a temporary withdrawal record, showing the disposition of the same until returned permanently to the files.

Securities held permanently for safe keeping should have a power of attorney lodged with the bank to execute the income tax certificates thus making the bank the authorized agent to sign these slips.

Letters of Credit.—In issuing letters of credit, the carbon forms made at the time of issue constitute the auditor's proof and from these the proper entries are made in the books of record. In such issues the bank incurs an obligation, and there must be an offsetting charge to balance the account. If cash were paid, the cash account would be charged, if a check were used it would constitute a charge against the customer's account, or if on another bank, would be equivalent to a cash payment.

In making an acceptance the bank incurs an obligation, and for so doing it must receive an asset in some form. The auditor must see that the bank receives something to offset the obligation entered into. In short, no obligation in the form of cashier's check, letter of credit, or acceptance may be incurred without the corresponding receipt of value.

[1] Edgar E Daniels, Auditor, Fidelity Trust Co , Philadelphia

Cash Letters.—In sending out checks for collection it is essential that their receipt be promptly acknowledged. Many banks are now enclosing blank forms to be signed by the receiving bank and returned. These cards should be checked against the charge in the books, or upon special records, so that the receipt of all cash letters shall be promptly known. Missing letters may then be quickly traced, otherwise several days might elapse before the matter would be brought to the attention of the bank officials. Where the letter requires a prompt remittance, acknowledgment is not necessary, the remittance being sufficient. If, however, it does not come to hand promptly, a tracer should immediately be sent out

Payment of Coupons.—In paying coupons a bank receives the funds from the debtor company and credits the account representing the transaction As coupons are presented they are charged by tickets. The coupons are cancelled and forwarded to the paying company at stated times The coupons so returned are checked with the charge tickets. Record is kept in a register of the coupons paid, and the coupons may be delivered to the auditing department for checking before being returned to the issuing company.

Currency Shipments.—All currency shipments are carefully checked. As the packages are sent out by express or registered mail insured, the contents are carefully counted, record made of their despatch certified by two men, the delivery to the post office or express office attested, and a record made of all such shipments in a proper record. The receipts at the destination are checked against the outgoing records, so that all such shipments are followed from their despatch to their receipt by the consignee

Deposit Liabilities.—All deposit liabilities of the bank are proven by "run ups" of the various ledgers, savings

cards, Christmas Club account, certificate of deposit book, etc. In the savings department the books are compared with the ledger accounts during a length of time sufficient to detect any irregularity in these accounts. The verification of the balanced pass books and statements rendered will act as a check upon the current accounts with checking customers. (The complete proof of liabilities will follow the plan outlined under examinations.)

Auditing the Bank's Expenses.—The auditor is charged with verification of the bank's expense account. He authorizes the payment of all expenses, or audits the accounts after being authenticated and paid by the expense department, if such there be. Postage stamps are bought in quantities and delivered upon requisition. Each department using the same is charged with the amount so used; but generally all mail goes out of the mail department, and stamps are thus used in but one department of the bank. The stamps are delivered to the mail teller upon requisition, and the amount used each day is ascertained. The mail teller must account for unused stamps and the stamps in the auditor's department are proven at stated times. The bank has the same control over postage stamps as over cash, and all such must be accounted for as having been used or in stock.

Old Records.—Inasmuch as a bank is often called upon to trace transactions several years old, it becomes necessary that all books and records be so filed as to be readily accessible. Some banks have their own storage vaults and others hire space in a storage warehouse The old records and books are filed in such form as to be quickly gotten at for future use. Correspondence is filed by years and subjects, deposit tickets by dates or names, cashier's checks by number, and the books of

record under their proper classification. A well-managed bank can in a short time locate any transaction that passed through its hands and produce the original entries. After due lapse of time the non-essential records may be destroyed. Thus the correspondence with other banks in routine matters may be kept for a year after reconciliation of accounts, but deposit tickets should be kept much longer and books of account for a considerable period of time—ten years or longer—and the corporate records should never be destroyed. These are the minute books, stock ledgers and transfer books.

In making an audit of the various departments, the auditor will go through the same process as a bank examiner. The difference lies in the fact that the auditor will make an examination of various departments at various times while the bank examiner examines the whole bank at the same time—a task quite impossible for the auditor who has a multitude of daily matters to give attention. This complete examination is now performed in many banks by public accountants who make a complete audit and examination under the direction of the board of directors, whose examination they supplant. In many cases the public accountants make an *audit and an examination* as distinguished from an *examination.* The former consists in a complete checking of the daily work for the period covered, while the examination includes only an appraisal of what the bank owns and what it owes. An examination is in no sense an audit, while an audit may be both an audit and an examination.

Bank Examinations.—In the conduct of banking it has been found necessary to have frequent examinations, made by public examiners who have no interest in the bank. The law so requires and good banking so demands. The purpose of such examinations is:

(*a*) To have an independent and complete audit of the affairs of the bank.

(*b*) To keep the bank within the law.

(*c*) To suggest such changes in methods and systems as shall make for better efficiency and more complete control

(*d*) To have an outside appraisal of loans and independent tests of their quality.

(*e*) To detect irregularities.

In the National Banking System it is required that the bank be examined twice a year by national bank examiners. In state banking systems, the same requirement is in force in many states, these examinations being made by state examiners. In some clearing house cities the clearing house has its own force of examiners who examine the member banks, and the Federal reserve banks also have a corps of examiners who examine member banks. It is also required that the board of directors examine the bank once or twice a year and report their findings to the supervising authorities. In some cases this is inefficiently done and no special forms are required; but in New York State, special examination schedules are provided for all bank and trust companies under state supervision, and these must be closely followed. It is permissible to substitute for the directors' examination, an audit made by a firm of public accountants; and there are many such firms now in the field, who make thorough and exhaustive examinations.

The Bank Examiner.—The field of bank examiner has attracted many brilliant minds It offers a wide experience, in that the examiner absorbs ideas from many sources, and gets a broad viewpoint of banking practice He also learns to recognize names of borrowers and comes to know their condition. It is the training school from which graduate many of our best and most successful bank officials It is a most valuable education.

That examiner succeeds in the highest sense who appreciates the fact that an honorable banker invites the closest inquiry into the conduct of his bank. He has nothing to conceal. He invites constructive criticism, but he abhors unjust fault finding. He is anxious to improve the system and welcomes suggestions for the betterment of the work.

Qualities of an Examiner.—A bank examiner should have certain fundamental qualities in order to fit him for this work. Aside from integrity of character, which is indispensable, he must have a thorough knowledge of accounting, particularly as applied to banking. He should have had bank experience in order to give him the banker's viewpoint, particularly in regard to loans He must know the routine of bank work and how the various operations are carried on. He must know the law of commercial paper. He must know the statute law of the state, if a state employee, and the National Banking Act and the Federal Statutes, if a national examiner. He must know credits and security values. He must have a good memory for names, thus allowing him to connect the loans in one bank with those in another, if such connection exists He must be forceful, tactful, discreet. and diplomatic. He must be able to gain quickly the good will of the bankers and at the same time hold their respect.

Causes of Bank Failures.—The history of national bank failures in the United States proves conclusively that banks are wrecked through two fundamental causes, namely, one-man control and defalcation. The former cause is the most prevalent. In the one-man bank the dominant figure is in position to dictate the loan policy of the bank. He is usually interested in several firms or corporations to the extent that the interwoven interests center around himself. Any untoward happening

in one concern affects all. It is a case of a wheel within a wheel with all its attendant dangers.

The controlling party borrows from his own bank, in his own name, all the law permits. He borrows the legal limit in the name of various companies. He also borrows in the names of dummies. Such borrowings have frequently been found to have been larger than the capital and surplus of the bank, and in many cases a considerable part of the total assets have been in loans to such affiliated interests. The amounts which have been loaned by banks to such an association of interests are scarcely believable, and the wonder is that the directors could sit idly by and see their positions jeopardized and the interests of the depositors imperilled by such a process. The collapse of the house of cards has brought about the failure of the bank, and then it became publicly known that the operator was so heavily involved that his failure meant ruin to the bank

The basic reason for thus allowing the assets to be concentrated in one line of loans would no doubt be found to be faith in the man and ignorance of his real condition. It is quite possible for a board of directors to implicitly trust and believe in one of their associates, and to innocently risk their good name through association with him. The law does not excuse such blind faith and charges directors with liability for such acts as by their actual or tacit consent bring losses to the bank.

In examining a bank, the examiner cannot know these interlocking relationships unless he makes careful inquiry into the setting of every loan. In order to detect and correct such a condition, he must analyze every loan in the bank, and ascertain the relationship, if any, of the one man to the loan in question. He may trace the proceeds of dummy loans into the possession of the central power; but such a close inquiry is only possible

when ample time is devoted to this detective work. And where the examiner finds that the bank is a one man bank, he should make this inquiry at whatever cost of time and effort it may require. He cannot make a safe examination otherwise.

In the matter of defalcations, it is a battle of wits. The perpetrator of the fraud carefully devises his plan and constantly watches its operation. He lives with his crime. In the many ways that are open to fraud, it is obviously impossible for an examiner in a few days to uncover what a man, as clever as himself, has taken months if not years to conceal. Many of the bank frauds have been uncovered by mere chance, and here the detective instinct of the examiner comes into play to scent danger. It is, of course, possible to check everything pertaining to a bank's operations and to verify every asset and every liability; but in the time allotted to such work on the part of an examiner, he cannot possibly cover such a detailed investigation.

Bank examiners have been publicly reprimanded and dismissed from the service for not having discovered irregularities in banks examined by them. But in the nature of things, the examiner making a periodical audit of a bank, and who is presumed to do the work in a given time, cannot make such a thorough test as will uncover a carefully planned abstraction. He is essentially an examiner and an appraiser. He cannot be an examiner, an investigator and a detective at the same time.

It is rare that a bank is forced to close its doors on account of losses suddenly taken. The process is slow, whether it be in the matter of loans or abstractions. Where the losses are the result of overloaning to one interest, it will be found that the loans are not made at a single time, as a rule, but that they have assumed dangerous proportions, gradually, as the needs of the

borrower became pressing. It is possible for an examiner to check such loan expansion in time to prevent future complications, if he is able to put together the various loans in various names and make a complete picture; otherwise he will be misled into believing that soundness exists where danger lurks unseen and disguised in the form of dummy and indirect loans Many banks have been reconditioned by a drastic process of liquidation forced upon the bank by the supervising authorities. By taking the matter in hand soon enough the directors have been saved from their own folly and the depositors saved from unwarranted losses.

The discovery of bank abstractions as a rule discloses the irregularities to have been spread over a period of time, often a number of years. The dishonesty may be said to have been cumulative, small at first and growing larger as the necessity became more acute and the dishonesty remained undiscovered

Such irregularities are easily hidden from the examiner, who cannot delve deeply into the daily work of the bank, but as a general proposition they would have been discovered in their infancy had a proper scheme of audit and control been in force to check the daily operations The looseness of method in many banks has proven to be an invitation to dishonesty

There are certain fundamental rules of bank audit that would, in a large measure, prevent bank embezzlements. At least the enforcement of these rules would detect dishonest practices at their inception Among these rules may be cited the following

1 Those who have custody of securities should not keep the controlling records.

2 The officers who draw cashier's checks, and other instruments of like character, should not reconcile the accounts with these liabilities

3. The bank reconcilements should not be made by the bookkeeper who works on the general ledger.

4. The pass books as balanced should be verified by one independent of the bookkeeping staff and tellers.

5 Pass books in the savings department should be verified by an independent auditor and should not be done by the tellers

6. Incoming remittance letters should be checked by various clerks in rotation and not left to one man continuously.

7 The work of the various clerks should be changed about frequently and for a time sufficient to allow any irregularities to be detected

8 Vacations should be insisted upon.

9 The work of the bank should be so planned that one man does not have control over two interwoven processes so that he certifies to his own work. For instance, if one of the officers is the treasurer of an organization, he should not be allowed to certify to the balance due the organization himself. He cannot safely act in two capacities at the same time.

In many banks it is not permissible for an officer or employee to have a personal account in his own bank. This prevents any manipulation of the account for irregular purposes. It is not possible, however, to prevent an officer or employee from operating through an account over which he has control This danger may be minimized by preventing such officers or employees from carrying accounts as executor, treasurer, etc., but would not prevent improper use of an account with which he had no direct connection. One of the largest defalcations on record was carried on for years by a bank official making charges to a large account over which he had control. Before submitting the statement to the principal, the balance would be altered

to show the correct amount due, thus deceiving the principal. But such cases are uncommon. Only a direct reconcilement will prevent such practices.

Assets such as securities, mortgages, etc., may be proven by their possession. Bonds are easily verified by count, and mortgages by the papers, properly recorded. There is only a remote possibility that a mortgage may be forged and this form of embezzlement is very rare. Assets in the form of *rights to collect money*, such as promissory notes, may be verified—not by the possession of the notes, which may be forged, but by communication with the borrower. This is an absolute check. *Any debt due to the bank may be verified through the debtor.*

Liabilities can never be absolutely verified from the books and should be proven by a check from without. It may be accepted as a safe rule to follow that the creditors (depositors) will know how much is due them from the bank. Therefore an audit of the deposit accounts by comparison of pass books in the savings department, and by a verification of the statements rendered in the checking department will, if properly made, detect manipulation of the deposit accounts. Certificates of deposit also respond to this method of audit. Securities for safe keeping and collateral held in loans may be verified by communicating with the customer. Defalcations may occur in spite of the foregoing tests, but they could not long continue. Such a detailed audit cannot possibly be made by an examiner, but devolves upon the directors. Many banks have this done at the periodical examinations made by public accountants, and these auditors as a rule make such verifications as a part of their auditing process. Bank defalcations are usually performed by trusted men in whom the directors have the utmost confidence. This confidence results in a lack of proper audit, thus opening the door to theft. Any

honest bank official welcomes such a test of the bank's affairs, since it proves his position; and any dishonest one knows that he cannot pass such a test. Therefore it behooves the bank directors to insist that a complete audit of the bank's affairs shall be made at least yearly as a matter of protection to themselves and the depositors and as a proof of the officials' integrity

The Course of an Examination.—Bank examinations are made without previous notice. While made with more or less regularity, so that the approximate time may be anticipated, it often happens that the examiner will be ahead of his schedule; and sometimes behind it.

Usually the examiner appears before the work of the day, but sometimes at the close. He proceeds as follows:

1. *Control of Assets.*—All compartments holding cash, securities, collateral, securities for safe keeping, loans, note files, etc., are sealed. This prevents any tampering with the assets, or any handling without the examiner's consent. The examining force should be large enough to make a quick proof of the work, in order not to retard the work of the clerks, and also to make the work of proving the more expeditious, on account of the numerous entries that must go through the work day by day. A "run up" of a ledger can be made much easier as of today, if it is done today. Tomorrow we have many items to eliminate and many to include.

2. *Cash.*—Cash is counted. First the counter cash, then the vault cash. Many examiners do not count silver in bags, if properly sealed; nor do they count every bill in the small packages. They may run through a package casually, counting an occasional package in full, on the theory that if irregularities exist, the amount could not be large in the silver and small bills. This is a matter for individual decision. Packages of $5 bills and upward are counted in full.

3. *Cash Items.*—Cash items are examined and only those properly in the work are permitted. Of such would be the petty expense account for a short period, checks for the next day's clearings (which are proved and examined) and such items as, for instance, Liberty bond coupons, and Liberty bonds bought from customers for immediate sale. But no "I O U's," or checks of any kind that have been cashed as an accommodation to anyone, should be permitted The cash must be "clean." Cash items are a frequent method of concealing irregularities, and each item should be properly accounted for and be above suspicion

4 *Statement.*—At this point the general ledger bookkeeper will take off a transcript of the general ledger for the use of the examiners in checking their work as it progresses.

5 *Due from Banks*—As soon as the examiner takes charge, the depositary banks should be written to asking them to forward to the examiner a statement as of the close of business the day before he makes the examination When these statements have been received they may be reconciled with the bank's own books at leisure It has also been found advisable to ask for a statement subsequently showing the nature of all checks charged back by the depositary for the succeeding five days, or longer, as the examiner may elect The examiner will of course make his own reconcilements and not leave it to any of the bank's employees.

6 *Run Ups.*—The following "run ups" should be made as soon as possible after the cash has been counted, in order that the work of the bank may proceed smoothly and also that subsequent changes in the accounts may not produce confusion, namely:

(*a*) The notes under discount. Those that have been sent out for collection will be evidenced by proper

records in the collection books. (No attention is paid to the quality of these notes; the object at this point is to prove the total.)

(*b*) The collateral loans.

(*c*) The ledgers holding accounts with depositors in both checking and savings department.

(*d*) The Christmas Club cards.

(*e*) The liability book.

(*f*) The mortgage loans.

(*g*) Certificates of deposit.

(*h*) Certified checks.

(*i*) Cashier's checks.

7. *Discounts*.—After the run up of the notes discounted has been made, the larger notes—those above a certain amount to be fixed by the examiner—should be checked into the liability book or into the ledgers, to detect any manipulation with the borrower's line of credit. In other words. *Who received the benefit of this loan?* Dummy loans are thus detected. Where there is any suspicion, the credit of the proceeds will show the beneficiary.

To illustrate. In a certain loan, it was suspected by the examiner that a certain party received the benefit, for the reason that the loan was in the name of one used by the individual in question as a dummy. The bank men were positive that the maker of the note received the proceeds. The examiner asked for the cashier's check that was drawn for the proceeds of the loan, and it bore the indorsement of the party suspected of having received the funds—proof conclusive!

As soon as each run up is proved with the general ledger statement heretofore mentioned it is marked with the name or initials of the examiner making the proof. Inasmuch as the bank force will constantly require

records, collateral, notes, etc., in the day's work, these are delivered and proper notation made. The work of testing the *quality* of the assets may then proceed.

8. *Collateral Loans.*—The examiner will examine the collateral loans, note the indorsements of part payments on the notes, and also the indorsement of payment of interest thereon. He will check the collateral as called for on the ledger with the collateral actually found in the envelope, observing that the necessary indorsements are on the back of the stock or bonds to make the same good delivery. In the absence of indorsement there should be power of attorney properly executed. Coupon bonds need no indorsement to make them good delivery. Where collateral has been taken out of the loan, there should be proper records and receipts for the missing securities.

The examiner will compute the market value of the collateral and note if any shortage exists. He will also see that the interest is not past due If the securities are not in the name of the borrower, there should be a hypothecation certificate from the owner, allowing the securities to be pledged.

Where a collateral loan has been made on real estate security the same papers should be in evidence as in the case of mortgage loans, namely, bond, mortgage, title policy, appraisal, insurance. The collateral loan register should contain the *numbers* of all securities held, in order to have a record of the same should any be lost or stolen The examiner should note the presence of slow, unlisted and unmarketable securities in the loans and recommend accordingly.

9. *Securities.*—The securities should be checked with the security ledger as to *par value.* In making up the final report these are appraised at their *market* value. The total of the book value must correspond with the controlling account on the general ledger. If the book

value is higher than the market value, the examiner should recommend such charge offs as the case warrants, where the book value is below the market, the bank has an uncredited profit that it may or may not take, depending upon the desires of the board of directors.

Securities are often held outside the bank by: The banking department as security for trust funds; correspondent banks and the Federal reserve bank, as security for loans; the government as security for postal savings and other government funds. All outstanding securities must be vouched for by the holding officials *direct to the examiner.*

10. *Mortgages.*—With each mortgage loan there should be: The bond, with proper indorsements of the payment of principal and interest, the mortgage duly recorded; the search or title policy; the appraisal; the insurance with clause running to the bank as mortgagee; and on the mortgage ledger there should be notation of the payment of taxes.

Inasmuch as it requires from one to six months or longer to receive back papers lodged with the recording office for record, all missing papers should be certified to by the attorney as being out for record. Note should be made that the amount loaned does not exceed the legal limit as established by the appraisal.

11. *Follow Up of Loans.*—In making a thorough examination, such as is done by certain examining bodies, a card record is made for each borrower, giving his line of credit with such details as the examiner may elect to take, at each examination. This also applies to collateral loans. On this card is also taken the average balances of the borrower and a digest of his statement. Thus all large borrowers are followed from time to time and the course of their loans watched. For instance, the examiner finds a loan of $10,000 It remains unchanged for

two years. The statement shows a net worth of $100,000, partly in stocks and bonds and partly in real estate. The average balances are less than $500. Evidently the borrower must be a very good risk, the bank generous in his behalf, or he has little ready money. If the loan is a good one, he should be asked to carry larger balances; and if poor it should be called The "setting" of the loan will determine what course to recommend. Where a loan has run for a long time with no reductions, it is either slow or bad, particularly where the borrower is not a good customer of the bank and does not show a statement that warrants the loan as a banking proposition.

It is true the examiner cannot know the ethical setting of each loan. What he should do is to offset the bank's personal knowledge of the borrower with his technical training and experience and recommend accordingly.

12. *Securities for Safe Keeping.*—Since the war, many banks have been keeping securities, particularly Liberty bonds, for their customers gratis. This was part of the selling plan to put the various issues over the top. The proper records in this respect are a matter of choice and a good plan will be found on page 555. The examiner will check the bonds in safekeeping with the book record, which should give the name of the owner, date left, amount and description of the various issues, numbers of the bonds if thought advisable, and total. The sum total of the securities found in the files must agree with the general ledger control. The receipts given to customers should be in duplicate, numbered, and all receipts issued should be accounted for.

13. *Capital Stock.*—The examiner should make a total of all outstanding shares of the bank, which amount should be the authorized capital. This may be done from the stubs or from the stock ledger

14. *Cashier's Checks, Etc.*—The outstanding cashier's checks, and certified checks may be obtained from the cashier check record and certification book. All outstanding checks should appear with the date of payment column vacant. By calling for the paid cashier's checks and checking with the book of issue, the outstanding cashier's checks may be obtained without reference to the cashier's record of payment In other words, the checks not in the bank that have been issued constitute the outstanding liability.

15. *Proof of General Ledger*—The total of the "run ups" of the various deposit accounts must agree with the general ledger. The examiner generally makes his own adding machine records, lest the machine totals be tampered with to conceal a discrepancy He takes nothing for granted. If time permits, the pass books in the savings department may be compared with the ledger cards as they are presented at the windows, and this is the usual procedure in savings bank examinations.

16 *Earnings*—The examiner will make a total of all earnings shown by the books since the last examination, deducting all expenses and interest payments. This will show the profit or loss from operation for the period. He may even go so far as to check the daily interest credits into income account, to prove that the bank has received credit for the interest earned as shown by the daily sheets In other words. Has the bank really received the income earned by it, or has some of it been withheld? Occasional tests may be made to determine this fact

17. *Expenses.*—The examiner may look over the classified expenses of the bank, and make such recommendations as he may see fit, although it is a prerogative of the board to determine how much shall be spent for various expenses connected with the running of the bank;

and as long as the board has not been grossly extravagant to the point of endangering the solvency of the bank, the examiner would have little or no right to interfere. If, however, the bank is weak, he may suggest limitations on expenses; and might even go so far as to issue a mandate to curtail that would be equivalent to a demand for economy.

18. *Minutes.*—The examiner will examine the minutes to get a general idea of the conduct of the bank, the manner of their keeping, the frequency of meetings, the attendance and the story of the bank as written therein.

19. *Real Estate.*—Real estate owned by the bank should be evidenced by deeds running to the institution and properly recorded. The law generally requires real estate to be sold within five years of its acquirement; and where it has been held longer, proper consents from the supervising authorities are required. These should be noted.

If the examiner has any suspicion that the bank is being mismanaged or its credit abused through the use of checks drawn upon it, he may request that all incoming checks pass through his hands as soon as received. By such a test he can see if any irregularities exist in this respect.

Irregularities and defalcations have been uncovered by merest chance as well as by thoroughness. Sooner or later the bank defaulter slips. He may be caught by an unexpected examination. He may be caught by taking nothing for granted. He may withhold receipts, and appropriate them to himself. He may reduce liabilities by charging against accounts amounts which he has abstracted. He may credit the customer with $6,000 in his pass book, keep $5,000 and make the bank record for but $1,000. This can only be detected when an audit of the book is made. Therefore in examining

banks, some examiners, notably the public accountants, endeavor to *advise the customers of their balances and the borrowers of the amount of their loans, and the collateral, if any, held by the bank.* Reconcilement slip is enclosed to be signed by the depositor or borrower showing the correctness of the account as stated.

By the foregoing process all claimed assets may be tested; and if the accounts are reconciled with depositors, and pass books examined from time to time, as complete a verification of liabilities is made as is possible in banking.

If any irregular notes are in the assets, communication with the borrower will disclose the fact; and if any collateral has been abstracted, a verification of the loans will uncover this. If, however, the defaulter should operate by paying off collateral loans that had a large equity, and destroy all evidence that the loan had been in the bank, until the borrower asks for his collateral back, he is safe; but this is flying into the face of providence.

CHAPTER XIX

THE CREDIT DEPARTMENT

The purpose of the credit department is to assemble information for the use of the bank and its clientele. While the information is primarily intended for the bank's own use, it freely places its files at the disposal of its correspondents Banks also interchange credit information with one another and with business concerns. The large banks not only have extensive information relative to their own customers but also credit information on a large number of prospective customers and those whom they have investigated. A leading bank in New York has upwards of half a million names in its credit files, many of whom are only prospective clients.

The Three C's of Credit.—In making loans upon open credit, the three fundamental elements of credit, Character, Capacity and Capital, must be given consideration; and the files must cover these factors thoroughly. Stated in other terms, the borrower must first be analyzed as a moral risk. His record must then be looked into to ascertain his ability as a business man, as evidenced by his business achievements. Lastly, his ability to pay must be considered from the viewpoint of his assets and liabilities, as set forth in his statement.

In making loans secured by collateral, the elements above mentioned do not enter except in a limited degree. If the bank were not certain of its position as the pledgee of collateral, it would not make the loan at all, although

in a falling market the elements of character and net worth would come into play to support a shrinkage in margin.

If, for instance, a loan were made on merchandise that suffered a depreciation to the point of endangering the loan, the borrower's ability to make good a shortage would surely be a factor; and if the loan became a menace to the bank on account of a fall in values, the borrower's moral qualities would be an important element. The collateral being insufficient would bring into play the borrower's willingness to take the loss or his intention to pass it on to the bank This condition obtained after the war when loans running into the millions became doubtful or bad on account of shrinkage in prices. Many borrowers disregarded their moral, and some their legal obligations, and forced the banks to take heavy losses rather than assume the same themselves. In this respect the character and worth of the borrower are important elements in making loans, no matter how well secured they may be at the time of their making.

The credit department is, however, particularly concerned with those loans made on open credit, with no security except the name of the borrower, supported by his assets and his ability to pay. Millions of dollars are loaned daily upon the general worth of business concerns and this form of borrowing may be said to be the most prevalent in American banking circles. Even the small country banks find it exceedingly helpful to have definite information about their borrowers, although their credit files are not so exhaustive as those of the city banks. The statement of the borrower constitutes the main element in the smaller banks, the average balances and average borrowings being taken off the books when required for loan purposes.

The credit department as such dates back to about 1890, being first in vogue in New York, spreading to other cities as the value of this department became manifest.

The commercial paper brokers maintain highly organized and most thorough credit departments for use in analyzing commercial paper sold through them. The offering of such paper is made only after a most intensive and exhaustive study of the borrower from every angle, and when accepted by certain houses and offered over their name is symbolic of quality.

One of the distinctive services rendered by the city banks to their correspondents is in the field of credit checking, and in order to buy paper for their customers and to check offerings made to them, definite information on open market borrowers is necessary. And as long as banks buy such paper in the open market the services of the city banks will be useful, if not necessary, even though they no longer serve their correspondents in the collection of checks. Many country banks buy paper only when checked by their city correspondents, and in order ethically to ask this service still maintain accounts in the reserve cities.

The commercial paper brokers, like the banks, not only file credit information on the names handled by themselves, but also other names which constitute prospective customers. The large houses aim to have credit files on all names that appear in the market so that the desirability or otherwise of the various names may be known to them.

The Scope of the Credit Department.—To attempt to state exactly what should go into a credit department would be equivalent to an attempt to state what should go into an encyclopedia Anything that has a bearing upon a credit risk properly belongs in a credit folder.

Credit is such a delicate thing that it is affected by the most trivial things. The credit man's detective instinct will come into play to read into little things large consequences. A judgment ordinarily means that the debtor is short of funds and his creditor has secured his claim by court action resulting in a judgment which constitutes a lien upon the assets. The amount may be small, yet the action is significant. As soon as a judgment is recorded, it is apt to be a warning to other creditors and as a rule other judgments follow quickly. Whatever the merits of the dispute, the record is harmful and all business concerns abhor judgments. Transfers of property, particularly to the wife or relatives, holds out a warning that the debtor is placing his property out of reach of creditors, and such transfers are investigated carefully. The recording of a mortgage places a prior lien upon the property that may also be harmful to creditors. Chattel liens upon machinery also create preferences that are heeded in credit circles. A debtor known to have overdrafts, short checks, "dated checks" passing through his bank is likewise getting into the doubtful class. Gossip, if such it may be called, about a business man, is always harmful, especially if it reflects upon his moral standing. A record of being slow pay among local tradesmen is an evidence of fast living, or uncontrolled living expenses which are also taken cognizance of. Any unethical practices, tricky methods, unwarranted return of goods, etc., also have a bearing upon a credit risk.

The Work of the Credit Department.—The work of the credit department consists of:

1. The assembly of information of every sort concerning business houses in all parts of the country, and particularly of their own customers This information consists of:

(*a*) Periodical statements, carried to a comparison sheet with the various items set in apposition from time to time.
(*b*) Reports of the commercial agencies.
(*c*) Reports of special investigations made by their own staff.
(*d*) Record of judgments, liens, transfers of property, mortgages, etc.
(*e*) Newspaper clippings.
(*f*) Transcripts of interviews.
(*g*) Correspondence relative to the name.

2. The average balances of customers.
3. Average borrowings of customers.

Supplementing the assembly of data is the furnishing of credit information to correspondents of the bank, customers and other banks seeking reciprocal credit information. The foregoing includes the "checking" of concerns borrowing on their commercial paper, sold through brokers with reference to the banks mentioned in the paper offering. This forms an important part of the work of the credit man.

Qualities of a Credit Man.—The credit man, whether in a bank or commercial house holds an important position. Upon his judgment large loans are made and large orders are accepted. While in the banks he does not, as a rule, pass upon loan applications, being rather an information bureau, in the commercial houses he is essentially the final judge as to whom to trust His qualities are many and varied, to wit:

He must know men and be able to judge them.

He must know business methods and practices.

He must know the terms, discounts and trade secrets of business.

He must be an accountant and able to analyze statements from an accounting standpoint.

He must know the law of commercial paper, collections, contracts and sales, as applied to the various states. He must know his rights in the courts.

He must be an observer of events.

He must be systematic, resourceful, careful, exact.

He must be a detective.

Credit Department Organization.—The organization of a credit department will depend upon the size of the bank and the character of its business. A small bank, handling only domestic business and without reserve accounts, will simply have a file for names with the credit information in folders. In the larger banks with wider ramifications, the department will be more thoroughly organized. Reserve banks will have a department that collects and classifies information about banks, both their own correspondents and others. The foreign business may be divided into countries and the domestic business by territory. The Federal Reserve Districts form a convenient method for this classification The division of the work into groups will require an executive head for each and he is usually a vice president There will be the usual assistants in the form of credit men, investigators, filing clerks, stenographers and field men. The work of investigating firms may be classified into kinds of business, such as hardware, millinery, produce dealers, grain, etc., so that the investigators become familiar with the names in the various lines and the personnel of the various houses.

Investigating a Credit Risk.—An application for a line of credit will immediately start the machinery of the credit department in motion. Assuming the application to come from a new customer the process will be as follows:

1. The borrower's statement will be taken on the bank's forms, and if an audited statement is available

this is much preferred. Banks and commercial paper brokers are coming to the point of insisting upon audited statements made by recognized public accountants. These audits, as a rule, are thorough and reliable, and set up in a form that is not generally found in individual unaudited statements.

A *comparative* statement is most helpful in that it gives a review of the progress of the business from time to time, showing the changes in the various items. After the bank has once established relationships with a borrower these figures will be kept on a comparison sheet in the credit folder. In many cases the bank will ask for these figures as a preliminary to borrowing.

2. The next step is to check the credit risk through two channels: (*a*) Banks and (*b*) commercial houses. It is presumed that every business house has a bank connection and many of them have several. The credit men and credit investigators now communicate with the banks and business concerns. The investigation in the banks will cover: (1) The general experience of the bank in handling the business of the borrower. (2) The amount loaned, the peak of loan requirements, the seasonal cleaning up, average balances and general opinion of the name. In the business houses the investigation will cover: (1) Whether the borrower has taken his discounts. (2) His general manner of payment, prompt or slow. (3) His business methods as to sales, turnover and profits. (4) Whether the concern borrows on its accounts receivable. (5) The general impression of the house regarding the name, line of credit granted and its policy toward it.

Supplementing the private investigation of the bank will be the reports of mercantile agencies, Dun, Bradstreet, Proudfoot, Bishop, etc.

Exchange of Credit Information.—Banks freely exchange credit information, both in person, by telephone and by letter Inquiries are received from business concerns and banks daily in respect to the credit standing of customers, and all such letters are promptly and intelligently answered as a matter of fairness to the bank's clients. The large city banks are constantly being used as the checking medium by other banks, particularly in respect to commercial paper. On all offerings of such paper the names of banks with which the borrower does business are given. These banks have accounts with the borrower and usually carry the name among their loans. So voluminous have these inquiries become that some of the banks are now using a form letter for each name. These letters are carefully prepared after the name has been investigated and checked and are placed in the files. As inquiries are received they are noted among the bank inquiries on the name and the form letter is prepared and sent out. This form letter holds good until the file is revised, or changes take place in the firm's condition that will warrant a revision of the opinion. A checking of a name among several banks will reveal a similarity of facts and often conclusions in regard to a name, showing that the banks have compared notes and also have been in receipt of the same basic facts.

Answering Credit Inquiries.—In answering credit inquiries banks quite generally use a special form of letterhead on which is printed a qualifying or conditional clause to the following effect:

> The information herein given and the opinions expressed are given in response to your inquiry and as a matter of courtesy only. No responsibility is to attach to the bank or any of its officers by virtue of statements herein made, and they are given and must be accepted under the foregoing conditions.

Filing Credit Information.—A large bank with a well-organized credit system files its credit information as follows:

1. Master sheet. On this is recorded a brief history of the account, name, address, how introduced, line of business, line of credit granted, direct and as indorser, name of broker handling the paper if sold in the open market, other bank accounts, etc.
2. Average balances and average loans, monthly.
3. Statements.
4. Comparison of statements.
5. Mercantile agency reports.
6. General information, reports of investigators, newspaper clippings, etc.
7. Judgments, changes in ownership, liens, mortgages recorded, deeds of property, etc , taken from published records.
8. Fire record.
9. Inquiries received and answered. These may be taken on a master sheet with names of inquirers and answer by reference to form letter.

It is helpful at times to know who has business or banking relations with the name, and this information is set up in the above section.

Some banks even take stenographic transcripts of conversations with the borrower as a matter of exact record of what was said during an interview. A borrower may sometimes be convicted of making false representations verbally in order to obtain credit.

The folders containing the various classes of information may be of different colors to distinguish them. Card indices are kept of all names in the files. The names may be classified into customers and non-customers, foreign and domestic names, etc. Or, they may be classified by cities, states, Federal reserve districts, etc.

It is highly useful to have a record of all commercial paper names which the bank checks and buys for its own account and for the account of correspondents This record may contain the amount of paper bought for its own account, and for correspondents, with date of purchase and maturity.

All current and active names will be given constant attention to keep the information up to date. Revisions at least half-yearly should be made on all names that are current.

False Statements.—The making of a false statement in order to obtain credit is, in many jurisdictions, now made a crime. Thus the Penal Law of New York provides :[1]

Any person

1 Who shall knowingly make or cause to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with intent that it shall be relied upon, respecting the financial condition, or means or ability to pay, of himself, or any other person, firm, or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring in any form whatsoever, either the delivery of personal property, the payment of cash, the making of a loan or credit, the extension of a credit, the discount of an account receivable, or the making, acceptance, discount, sale or indorsement of a bill of exchange, or promissory note, for the benefit of either himself or of such person, firm or corporation, or

2. Who, knowing that a false statement in writing has been made, respecting the financial condition or means or ability to pay, of himself, or such person, firm or corporation, in which he is interested, or for whom he is acting, procures, upon the faith thereof. for the benefit either of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section, or

3. Who, knowing that a statement in writing has been made, respecting the financial condition or means or ability to pay, of himself or such person, firm or corporation, in which he is interested, or for whom he is acting, represents on a later day, either orally or

[1] Section 1293 (*b*)

in writing, that such statement theretofore made, if then again made on said day, would be then true, when in fact, said statement if then made would be false, and procures upon the faith thereof, for the benefit either of himself or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section,

Shall be guilty of misdemeanor and punishable by imprisonment for not more than one year or by a fine of not more than one thousand dollars, or both fine and imprisonment.

In proof of the care and thought used in checking credits, may be cited the custom in some brokerage houses and banks to prefer that credit statements be sent by mail. When so received the envelopes are attached to the statement, time stamped and signed and witnessed by those receiving the statement. This practice is for the purpose of proving the use of the mails to defraud in the event that the statement proves to have been false in the making.

This is as it should be, for otherwise the creditors are without redress in cases where a borrower stoops to this practice. Relying upon the facts as set forth in a statement, money is loaned and goods are sold, and if these facts be untrue the creditor is dealing in the dark with a criminal.

Where a borrower is dealing with several banks, a comparison of their business with the borrower will often avoid future losses, as will likewise a careful analysis of all statements obtained from him. In a case now in the bankruptcy courts, the borrower made yearly statements to his banks. The statements showed a steady and healthy progress. He dealt with three banks. In one of his statements he showed bank loans of $44,000. As a matter of fact his loans in one bank exceeded this sum, and his total obligations were more than $65,000. Had the bank carrying the largest line taken note of the fact that his loans from them were

more than the total shown on the statement, it could have immediately taken steps to protect itself. As a matter of fact it subsequently took a loss of the entire amount. The borrower was indicted under the section of the Penal Law quoted above, for obtaining credit under a false statement, but had gone into bankruptcy after a questionable fire and his creditors got nothing. The indictment could not bring back the lost money; but a more careful checking of his statements might have saved all the banks in question heavy and unnecessary losses.

Value of Comparative Statements.—The value of comparative statements cannot be over estimated. Such a process will often reveal inherent weaknesses in a business unknown to the concern itself. Many business men are not analytically inclined and are satisfied to make a profit, not knowing how the profit was obtained, and often taking concealed losses which could have been prevented. Dangerous tendencies may also be detected by the comparison process. Thus, in analyzing the comparative statements of a large automobile business it was found that the accounts payable were running up, while bank loans were running down. Profits were fairly substantial, yet the firm was making no adequate additions to surplus. The conclusion was easily arrived at that the concern was paying the banks at the expense of the merchandise creditors and thus losing its credit standing in business circles. At the same time it was found that the proprietors were taking out practically all the profits and living too well. They were not fortifying themselves for a bad year. The profits from the sale of cars were absorbed in too large an overhead, and the repair station was not making the money it would have made under better control. At the suggestion of the banker, proper corrective measures were

instituted and the whole business revamped to the lasting profit of the owners and to the safety of the banks and business houses dealing with this concern.

Value of Independent Audit.—The independent audit of a concern has many advantages over a self-made audit, among which may be mentioned the following:

1. The auditor has no interest in making anything but a correct statement. His professional honor is at stake, which honor is as high in the accounting profession as in any other. A public accountant of integrity will no more stoop to unethical practices than will a physician or lawyer.

2. The owner of the business cannot be expected to make an unfavorable report about his business if it is possible to prevent. He does not invite unfavorable comment and perhaps action on the part of his bankers

3. Frequently the bookkeeping system of the concern is so crude and so poorly kept that it does not reflect the true condition of the business The officers or the owners do not know their condition, and many assumptions on their part are false.

4. The auditor will recommend if not insist upon an adequate bookkeeping system that will fully set forth the facts. Such a system is essential to the proper conduct of any business, however small. In many cases the result of an audit and better bookkeeping system will reveal facts unknown to the owner himself. Such facts are necessary in considering the position of the business as a credit risk. An illustration will be in point: A certain builder doing about $300,000 of business a year had a crude and poorly kept set of books He thought he knew approximately what he was making on each job and also what he drew out of the business. He claimed in one year to have made $13,000 and to have drawn but $50 a week for himself. An audit

showed that he had made $20,000 and had withdrawn more than $10,000 for himself and family and did not know it. The banker was lending on a credit risk that no one knew about, on account of a lack of audit. Any expense incurred in making an audit will be amply justified in the knowledge of the facts and in the saving made possible by more accurate records and control. A thorough audit is cheap at any price.

Comparisons.—A comparison of the business of one firm with another in the same line is most helpful as showing the contrast or the agreement as to turnover, collections, receivables, etc. It will be found that a marked similarity appears in the statements of firms in the same line of business and working in the same section of the country. This makes for strength in the fact that the same features appearing in connection with different firms demonstrates the stability of the practices. And where a firm shows a divergence from the established standards it calls for an explanation as to the reason.

These comparison sheets, showing at a glance the business for three or more years, are most helpful as showing the trend of the business. Trouble is often avoided by heeding the warnings shown by such comparison; and when the concern gets into difficulties the reason will often be found to have been clearly indicated in these comparison sheets.

In checking names, it is helpful, to say the least, to ascertain if the firm is giving one bank or broker a preference over another in the form of indorsement or guaranty. Some banks have been found to have gained a preference over all other creditors by obtaining an indorsement or a guaranty of their paper, to the detriment of the general creditors. This feature will be revealed by asking the banker if he has single or double name paper.

Credit Agencies.—Practically all lines of business now have credit agencies of their own which specialize in their own fields. Of such are the lumbermen's, the jewelers', shoes, produce, grocers' agencies, etc., that keep close watch on firms in these respective fields. They are supported by their own members and besides obtaining information on all firms in the respective lines, report all judgments, actions at law, delinquent debtors, failures, bankruptcies, assignments, etc. These organizations make prompt reports on all firms in trouble, and have done a great service to their members in keeping them informed of the condition of dealers in their particular trades.

There are also special reporting companies which specialize in judgments and watch all offices of public record for such entries They also publish judgment books and render special reports on all such cases.

Still other agencies, such as Bishops' Service, and Proudfoot's, report more intimately on persons as distinguished from firms. They make special and private investigations on such names as are submitted to them, often going into the moral risk more thoroughly than into the business aspects of the individuals.

The Moral Risk.—The moral risk, even though the security be ample, is an important factor in credit matters, as will be seen from the following illustration: A certain coal operator purchased a rundown property at a nominal figure. He proceeded to build a breaker upon it and to mine coal. He placed two mortgages on the property, one of $100,000 and another of $300,000, represented by bond issues. He used the bonds for bank loaning purposes and incurred large obligations in the course of a short time. The entire property was never worth more than $100,000 and he operated this mine less than a year. He took one order for 10,000 tons of coal with an

advance payment of $15,000 at the time the contract was signed. He delivered 80 tons and shortly afterward closed the mine. He never paid any interest on the bonds, or royalties on the coal mined He then allowed the first mortgage to be foreclosed and bought the property in himself for $25,000 to the heavy loss of all the bondholders.

Thereupon he bought another and larger mine of better quality and sought to place a million dollar bond issue on the second property through a firm of high standing in New York. The property was ample security for the issue and after long negotiations and careful investigation the house agreed to underwrite the bonds, when they discovered the details of the previous operation. Negotiations were promptly broken off. The moral risk as evidenced by the first transaction was such that no house that valued its name could afford to be sponsor for an operator of this character.

The moral risk as established by a man's previous performances plays a very important part in all credit matters and is everywhere given the weight that is properly due it. Any breach of good faith and any fall from business virtue is disastrous to credit and no one is so well fortified in property that he can ignore this vital element. The last mentioned agencies specialize in this feature of credit investigation.

The term "moral risk" is generally used to indicate the character of the credit risk as determined by the debtor's integrity and ability. All successful business is built upon honor, and no business can long exist if it is built upon dishonor. The term *integrity* in business means that every transaction shall be exactly as represented. Every sale must be satisfactory to the buyer. Every advertisement must be supported by ability to perform and the performance must be exactly as prom-

ised. No deceit shall enter, and the old principle of *caveat emptor* (let the buyer beware) does not find its proper place in concerns where integrity rules.

There are some concerns whose spoken or printed word is accepted as fact. Goods are advertised exactly as they are, and are sold as advertised. Any representations made by salesmen are to be accepted as true, and the firm will live up to its agreements; nay more, it will live beyond its legal obligations. The promise will not only be performed, but performed—plus. It will do more than it is obliged to do. Perhaps an illustration will show this point more clearly than abstract treatment.

A firm in New York bought a rug from a department store. It began to show wear a few months after purchase. The seller was asked to inspect it and upon doing so agreed that it was not up to their warranty and offered to replace it without cost Another rug was loaned during the interim, and when the new rug arrived, with it came a letter and a check. The letter stated that the price of the rug had gone down and the price was then $9 less than the buyer paid. This is business honor. The firm was in honor bound to replace a defective article; but it was under no legal or moral obligation to make a rebate. It was more than honest. The good will which such practices ultimately build up is invaluable and can be secured in no other way. And in the firm above referred to, such matters are common practice They are the rule and not the exception. In consequence there has been built up a business which will undoubtedly last for all time

Banks and business houses give great cognizance to this element of honor in business and regard it as the very bed rock of business success. Fortunes have no doubt been made by other processes, but the fortune

has been tainted and in many cases dissipated in due course of time. It lacked enduring qualities

Ability.—One of the most pitiful conditions to be found in business life is that of mere honesty—a negative virtue that has never been anything but good. While honesty is a virtue of great value, in itself it accomplishes nothing. Thousands of men who were honest until it hurt, are business failures. Their honesty got them nowhere because it lacked the offsetting virtue of ability The honest man who is an able man will become a successful man; but if he is honest and without ability, he can never achieve success. If he is dishonest and able, he becomes a crook

The ability to manufacture goods—honest goods—makes the great manufacturer. The ability to sell honest goods makes a great merchant. The ability to manage a bank makes a great banker, and the ability to convey information makes a great teacher. Ability to absorb facts, digest facts, form conclusions and present arguments and move audiences makes a great lawyer, preacher or statesman. Ability makes executives and executives make great institutions.

In passing upon credit, this vital element is given due weight What has this man done? is the pivotal point in credit investigation. Has he, by sheer ability, risen from the ranks and become a success? Has he made his way from nothing to something? Is he a proven success in business? Has he turned ability into property? Has he made money and kept it? Has his ability built anything permanent? Has he managed and controlled a business?

In reading business history as found on credit statements,[1] it will be found to run somewhat along these lines.

[1] See resumé of the history of business houses in the credit statements, hereinafter analyzed

This business was established forty years ago by Mr. X. He started with a capital of $1,000 which has been increased out of profits until it now stands at $1,000,000 fully earned in the business The concern has always enjoyed the confidence of the banks and the trade It manufactures a line of high grade and well-known shoes which command a steady trade under the trade mark Its established trade carries with it good will which is highly valuable but is carried on its books at only $1 It has never had a fire, no judgments have ever been taken against it and the founder is still the active head who takes a leading part in all that makes for the betterment of his community in which he is highly respected

Stated in other terms, the history of all established business would parallel the above, which simplified means. "Here is an honest man who has made good."

Due weight is therefore given these two factors in business life, and their presence in the affairs of business men can only be known by a survey of their business career, which, while stated in facts, can more easily be stated in conclusions as the deduction of submitted facts.

Dun and Bradstreet Agencies.—The two great agencies Dun and Bradstreet have, through years of operation, gathered an enormous amount of information about business houses in all parts of the country and publish their regular reference books every six months. These books give the credit rating of concerns in even the smallest towns and hamlets in the United States and Canada. Investigators cover all parts of the country and follow up all new names as fast as new business concerns open their doors.

Besides the published volumes, which contain merely the rating, as "$10,000 to $20,000" first credit" (by symbols), these agencies are in position to render a complete report on practically any name that is a business risk. These reports are rendered to subscribers only and give the following information:

History of the business.
Ownership and changes in the same.
Digest of the statement.
Result of investigation among the trade
Fire record.

In the larger cities these agencies have branch offices which cover their respective fields intensively by special investigators who circulate among the banks and business houses, constantly gathering current information about the firms under investigation.

The fact that a name is not listed or rated does not, however, necessarily mean that the firm has no standing; for many firms of high standing have steadily refused to submit their statements or be interviewed concerning their business. They ask for no credit except from houses with which they have had long connections, and do not seek accommodation in the open market. Some concerns pay cash for everything purchased and are therefore not credit seekers; but there are few such. The ratings mentioned above must be taken as opinions arrived at after investigation carefully made, but subject to false statements and erroneous impressions conveyed to the investigators. The ratings are established from the statements submitted and are only as reliable as the statements are true. The agencies guarantee nothing in respect to their reports They perform a useful and necessary function in the field of credit but are subject to human limitations.

Credit Men's Organization.—The National Association of Credit Men is a large and powerful organization which seeks to build up sound credit methods among its members, promote legislation in respect to uniform sales acts, false statements, collections, etc., and all matters pertaining to credit and business Local credit organiza-

tions operate in a restricted territory and the central office keeps a record of all undesirable customers as reported by their members. They are essentially credit clearing houses which assemble credit information from the merchants, and have available definite information about credit seekers which is at the disposal of the members. Confidential lists of undesirable risks are sent out for the information of members, the aim being to eliminate unsafe risks from the business world from which the seeker derives a benefit at the expense of the merchants. The banks not only encourage such organizations but help support them and freely cooperate and exchange credit information with them

CHAPTER XX

LOANS AND DISCOUNTS

In the opening chapter it was seen that one of the fundamental functions of banking is to loan money. It would be more in keeping with the facts if it were stated "money and credit," for a large part of the so-called loans are not made in the form of money, but as credits on the books, against which cash may be withdrawn or checks issued. In the majority of instances the proceeds are credited to the maker's account, and the disbursements are in the form of checks, so that the bank has *created* credits, against which it *honors* other credits

Were it not for its loans a bank could not exist, for out of loans in various forms arises interest, which is the life blood of the bank. Only a minor portion of an average bank's income is received from sources other than interest. Exchange, commissions and fees of various kinds contribute only a very small part to the total earning power of the banks.[1] Even investments in bonds are essentially loans to the borrowing corporations, municipalities and governments. The *form* of the loan in a bond investment is more dignified, but it is a loan nevertheless.

The term "loans and discounts" is commonly used in banking circles in the United States to denote the loan operations of the bank. Technically speaking a loan is an advance of money, either secured or unsecured,

[1] Trust Companies which have built up large and profitable Trust Departments are the exceptions to this statement Fees for transferring stocks constitute a large part of the earning power in the Trust Department.

where the interest is collected at the maturity of the loan, or at stated intervals. Unsecured *loans* are not so common as the secured or collateral loans. The term "discount" properly applies where the loan takes the form of a purchase of a negotiable instrument *at a discount.* The bank loans the funds by accepting a promissory note payable at some future time and deducts the interest from the face of the note. It *discounts* the instrument for the time it has to run. The interest is collected in advance; and in a strictly legal sense the taking of such interest would constitute usury, were it not for a provision in the law that such an act shall not operate to make the transaction usurious.

The distinction may be seen by contrast. A borrows $1,000 of a bank on his promissory note payable three months hence "with interest." He will receive the full amount, paying the interest when the loan is due.

If a discount of a $1,000 note were made for three months at 6 per cent he would receive $985, the bank collecting the $15 in advance, which is called the "discount." The bank has advanced but $985 and collected interest on $1,000.

As a rule discounts are made on the unsecured notes of customers of the bank, with or without an indorser, and they also consist of the notes taken by customers of the bank in their business dealings, sold to the bank at a discount, and are commonly called "notes discounted."

In some banks there is a form of loan called "Demand Bills" which consists of demand loans made without security. This form is used where the borrower does not want the loan for a stated period and prefers to have the option of paying it at his convenience.

Power to Make Loans.—The power to make loans, or better, to establish a loaning policy, devolves upon the

board of directors. All banks have, however, a loan committee, by whatever name it may be called, with power to pass upon loans between board sessions. This committee may have power to loan up to certain limitf, or it may have a free hand. In order to expedite the loan process, certain powers are delegated to the officers who may make loans within certain prescribed limits at their pleasure In this respect there are two general courses pursued· (*a*) To give the officers an unrestrained hand in making loans, either by direction or assumption; (*b*) to delegate to certain officers, either individually or collectively, the right to make loans within certain restrictions In the first instance, the loans are made by executive officers on their own initiative and upon their own judgment, and reported to the board as required by law. Such a bank can never be as wisely administered as where the loans are passed upon by a combination of minds, one offsetting the other, and one balancing the other. On the principle that two heads are better than one, joint action and approval is always safer than individual action.

Bank supervisors of long experience have gone on record against the "one-man bank" as unsafe. The record of bank losses attests the fact that an unrestrained hand in making loans invariably leads to looseness in the loan policy that is costly if not dangerous. Favoritism, friendship and politics enter into such a policy that cannot be anything but harmful to the best interests of the bank. The man who thinks his judgment infallible and his conclusions always sound has yet to learn that human nature is frail and prone to err, and the autocrat in banking usually comes to grief.

On the other hand, it is possible to make the loan policy so dependent upon committee action that the work of the day is seriously hampered and the good will

of the customers imperilled, if every application for credit is held over for committee action. Some loans must be made quickly or not at all. But this is not to say they should be made carelessly. From an experience covering this very point, the author has found that the most workable plan is to allow the executive officers to make loans within certain limits established by the board. Loans in excess of such limits are referred to the committee. Placing the men upon their honor and giving them certain distinct privileges makes for efficiency as well as safety and develops a high degree of intelligence in handling the loans as they are presented.

The business man who knows his position is sound and his request in keeping with his ability, his worth and his standing, insists upon a quick answer to his requests Executives are expected to be able to make decisions, otherwise they would not be executives. They cannot always be right, and it is not expected they always will be; but valuing his position and cherishing his good name, the true executive will act with caution as well as dispatch.

Forms of Loans.—Bank loans take various forms, depending upon the wishes and business customs of the borrower or the requirements of the bank. The loans usually found in a bank are as follows:

1. Unsecured loans (discounts) made upon promissory notes. These are as a rule indorsed, either for value or as accommodation. They may be time or demand loans When indorsed they are commonly spoken of as "two name paper."

2. Secured loans. These may also be time or demand, but have pledged as collateral various kinds of security, namely:

(*a*) Stocks and bonds.

(*b*) Various commodities in storage, commonly called *warehouse loans*.
(*c*) Real estate, commonly called *mortgage loans*
(*d*) Accounts receivable.
(*e*) Chattel mortgages or trust receipts
(*f*) Goods in transit, secured by bills of lading

Classification of Loans as to Time.—Bank loans are made in several ways, as regards the time element: (*a*) On demand. These loans are payable on call, but in many banks are treated as loans without definite due date and are allowed to run as long as the collateral is sufficient to safeguard the loan and the interest is promptly paid. They are optional as to payment either with the borrower or lender; (*b*) time loans (discounts) made for a definite time, usually expressed in months or days; (*c*) "street loans," "call loans," or "day loans" are loans peculiar to the money centers, particularly New York. They are collateral loans made to brokerage houses and bond dealers and have a procedure distinctly their own. They are made by banks direct to the borrowers or through the medium of money brokers. Such loans are made for the purpose of clearing the daily transactions of the bond and stock exchange houses, which require large sums of money to effect their settlements

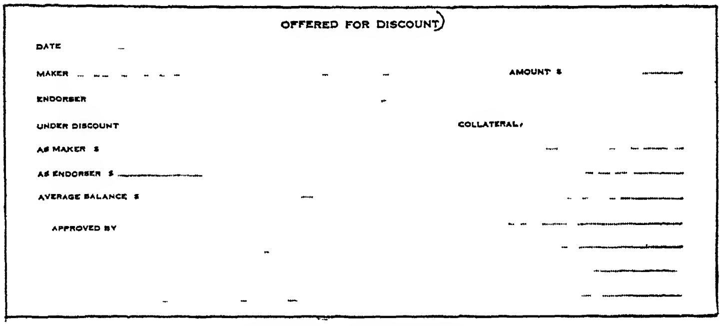
For accounting purposes, loans may be classified according to their character as follows.

1. Discounts, unsecured—meaning single and two-name paper unsecured, made to customers of the bank (time loans).

2. Commercial paper, bought in the open market, sometimes called *purchased paper*.

3. Demand street loans—collateral loans made to stock exchange houses, payable on demand.

4. Demand collateral loans made to customers and secured by collateral
5. Demand loans unsecured.
6. Demand merchandise loans, secured by merchandise in warehouse or bills of lading on goods in transit.
7. Time merchandise loans, secured by merchandise in warehouse or by bills of lading on goods in transit.
8. Advances against arrival drafts.


OFFERED FOR DISCOUNT

DATE

MAKER

AMOUNT $

ENDORSER

UNDER DISCOUNT

COLLATERAL

AS MAKER $

AS ENDORSER $

AVERAGE BALANCE $

APPROVED BY

FORM 46.—Offering slip

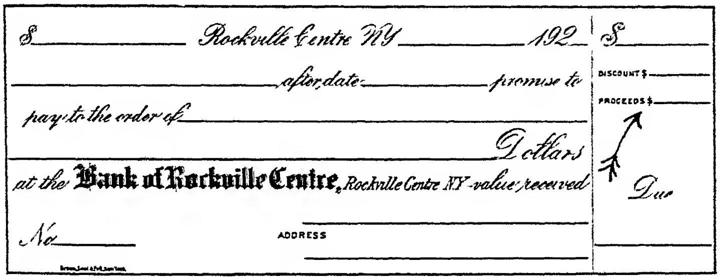
The Mechanism of the Loan.—A clear idea of the loan process may be obtained by following a loan from its inception to its entry on the books of the bank.

The Offering.—The application for a loan is made to one of the officers of the bank. At this time the purpose of the loan will be inquired into, and a statement of the borrower taken, if the same is not already on file and of recent date The application may be entered in an offering book, or upon a blank, containing such details as maker, amount, time to run, indorser.

Present Status of the Borrower.—From the officer's desk the application goes to the credit department. Here such information about the borrower is compiled as will act as a guide to the credit risk of the borrower.

Amount under Discount.—From the credit department the application will go to the loan department where the present loans of the borrower will be entered as to amount direct and indirect, or as maker and as indorser

Average Balances.—From the loan department the application will go to the bookkeeping department where the average balances are kept and these will be entered, as for instance, average for present month, average for six months, etc.



$ ________ Rockville Centre N.Y. ________ 192__ $ ________
________ after date ________ promise to
DISCOUNT $ ________
PROCEEDS $ ________
pay to the order of ________
________ Dollars
at the Bank of Rockville Centre, Rockville Centre N.Y. value received
Due
No. ________
ADDRESS ________

FORM 47.—Promissory note with provision for computing discount and proceeds

Committee.—When the information is assembled, the application will go to the loan committee which finally passes upon the application.

Entry into Books.—After receiving the approval of the committee, the note is made out and given to the note teller for discount The note is timed, discount figured, net proceeds credited to the borrower's account and interest or discount credited to "unearned discount." The note is entered in the *note register* which records all loans as they pass through the bank.

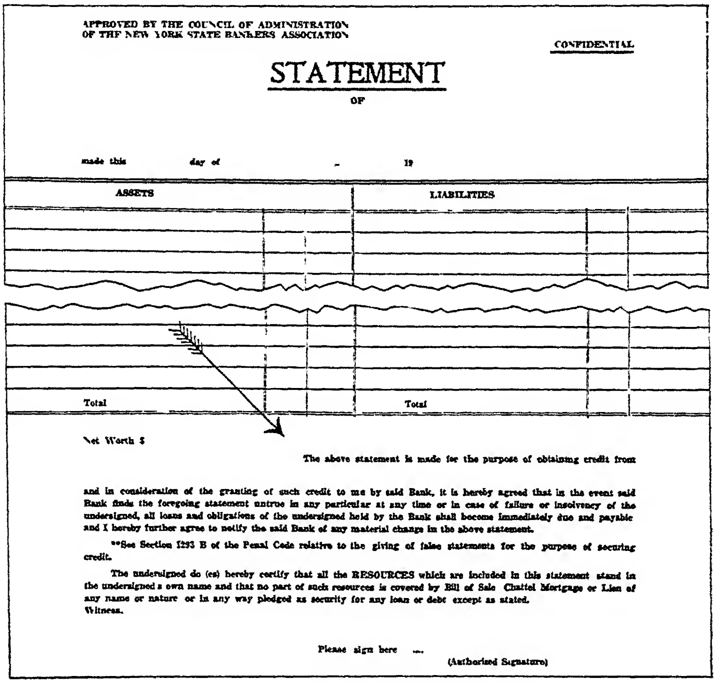
The note is entered in the *liability book* under the borrower's name, then in the *maturity book* under its due date, and is ready for filing in the note files under its due date.

Offering Book.—Notes offered for discount are entered in an offering book which becomes the original entry of all such transactions. The information taken need not be so detailed as in other records, if sufficient to identify the transaction. Such would be: Date of offering, maker, indorser, amount and time to run. It may, however, be more elaborate and become the discount journal with full details of each transaction. In such case it would record Date, maker, indorser, where payable, time, rate, maturity, amount of discount earned for one day, etc. This book may be further classified into: Straight loans, customer's paper discounted, acceptances, commercial paper, etc., thus keeping a record of all classes of discounts made. Other details may be entered in this book, such as discount collected but not earned, stamps attached to the instruments discounted, exchange collected, disposition of proceeds, etc. The footings of each column at the end of the day constitute the debits and credits in the general ledger for the respective accounts.

Whether the offering book be simple or complex, it is generally submitted to the discount committee at stated times for their approval. When this is signed it fastens the liability of the various members as to the loans so made. Therefore, a member who signs the book cannot afterward disclaim responsibility for loans made with his approval.

Initialing of Notes Discounted.—It is a most excellent idea to have all notes which go through the work initialed by those who handle them This aids in placing the responsibility for anything that may subsequently arise in connection with such loans. Thus, the officers who authorize the making of the loan will initial the notes; the bookkeepers who figure the discount and make the book entries will attach theirs, and the one who places

them in the files will attach his initials. Should there afterward be found an irregularity, one cannot point to the other and say in the language of Nast's famous cartoon "Twas'nt me; 'twas him." How this works may be seen by illustration. A note was found in the assets



APPROVED BY THE COUNCIL OF ADMINISTRATION
OF THE NEW YORK STATE BANKERS ASSOCIATION

CONFIDENTIAL

STATEMENT

OF

made this day of 19

ASSETS			LIABILITIES		
Total			Total		

Net Worth $

The above statement is made for the purpose of obtaining credit from

and in consideration of the granting of such credit to me by said Bank, it is hereby agreed that in the event said Bank finds the foregoing statement untrue in any particular at any time or in case of failure or insolvency of the undersigned, all loans and obligations of the undersigned held by the Bank shall become immediately due and payable and I hereby further agree to notify the said Bank of any material change in the above statement.

**See Section 1293 B of the Penal Code relative to the giving of false statements for the purpose of securing credit.

The undersigned do (es) hereby certify that all the RESOURCES which are included in this statement stand in the undersigned s own name and that no part of such resources is covered by Bill of Sale Chattel Mortgage or Lien of any name or nature or in any way pledged as security for any loan or debt except as stated.
Witness.

Please sign here
(Authorized Signature)

FORM 48 —Statement for borrowers

improperly signed. It bore the initials of an officer, the bookkeeper and the cashier Each should have discovered the discrepancy—neither did, yet all were responsible for the oversight Another: A certain officer made a loan on certain collateral. Another officer took him to task for so doing. "But," said the other "you made a similar loan for the same sum on exactly the same amount and kind of collateral." The allegation

was denied, whereupon the loan papers were brought out and on the note appeared the initials of the protesting official. He was confronted with incontrovertible evidence against himself. In banking practice it is absolutely essential to place the responsibility where it belongs.

Bookkeeping of the Discounts.—The first book of record in keeping discounts is the discount register or blotter. This is a journal record of all notes discounted day by day. The information taken is: Number, date, maker, indorser, amount, time to run, maturity, discount and net proceeds. The purpose of this book is to have a record of all notes passing through the discount process of the bank. It becomes most important at times to be able to trace a certain note in its course through the bank, from a historical standpoint, as it were. Such transactions are frequently called for in court proceedings, and a well-managed bank is able to give the history of every note handled by it, no matter how long it may have been in its discounted bills. A number is given the note at this time, corresponding to the line on which it appears, which number follows it through the other books.

Liability Book.—The law prescribes how much of a bank's funds may be loaned to a single borrower, usually a certain proportion of its capital and surplus. In order to know how much a certain borrower has been loaned, it is needful that all his notes be assembled in one record and there summarized. The board of directors or the executive committee may have fixed a limit to his borrowings, and unless the amount loaned him be known, there is no way of ascertaining if this limit has been exceeded. The liability book records this information.

It is also needful to know how much the borrower has been loaned on his own name and how much on his

customer's paper. One is a primary loan, the other secondary; and the law makes a distinction as to which kind of loan it is in fixing a maximum. Thus, the bank may be restricted to 10 per cent of its capital and surplus as the maximum it may loan to one borrower on his single name paper, while it may have no restrictions as to the amount advanced against his customers' paper. Therefore the liability book records under "as maker" the amount loaned him on notes which he has executed as maker; while it also records "as indorser" the amount loaned on paper on which he appears as indorser. The information taken on this book usually is: Date of transaction, number of note, maker, indorser (or vice versa), maturity and amount. The total of each class is carried from day to day, and as notes are paid they are crossed off the record and the amount reduced, and as new ones are added they are listed and the amount increased. By following a number down through this record, it will show how many times it has been renewed, what the reductions have been and when it matured. It is a book of constant reference and in use all the time. The total of this book must equal the amount of discounts found on the general ledger.

Maturity Tickler.—It is essential that all maturing notes be presented on the day, at the place payable and to the party obligated to make the payment. Therefore the exact due date of all notes must be known and for this purpose a *maturity book* is kept, showing all notes due each day. The notes themselves will be found in the note files under the same calendar date. The discount clerk knows just what notes are falling due each day for attention; the officers know how much is due for re-loaning purposes. Notes due out of town are taken out of the work and sent forward in time for presentment on their due date. Other notes are collected by messenger and

notes due at the bank itself are charged to the maker's account. The information taken on this book is: Date, maker, indorser, amount. The classification under due date eliminates the necessity of taking the due date

The entries in the maturity tickler may be classified into Customers' own notes; customers' notes discounted, commercial paper; acceptances, etc., thus showing how much of each class is maturing each day.

Discount Files.—In filing paper in the note files, it is helpful to segregate the paper into classes, such as country items and city items. These may be subdivided into discounts, acceptances, etc. They may also be classified into those eligible for rediscount at the Federal reserve bank and ineligible paper, so that if rediscounting is necessary, the paper will already be classified. After filing, the paper should be checked against the maturity tickler to insure that all items have been accounted for and are properly filed. This will also prove the listing in the maturity tickler.

The Carbon System of Note Recording.—A system has been devised whereby several carbons are made for each note The slips are numbered and correspond to the number of the note, or rather the number of the note corresponds to the consecutive number of slips At one writing several entries are made, the slips being so worded that they respectively become, the note register, maturity tickler, liability record, notice to borrower and credit ticket. These slips are filed in card files, the liability record being kept on a master card for each borrower, the details being found on the slips following It is a great time and labor saver

In the quintuplicate loan record system[1] all records are made at one writing—the Discount Register, Direct

[1] With acknowledgment to the Baker-Vawter Co, Benton Harbor, Mich

Liability, Note Notice, Maturity Tickler and Endorser's Liability, which eliminates chances of error which are always present in the old plan of writing each record separately. There is a corresponding saving in time.

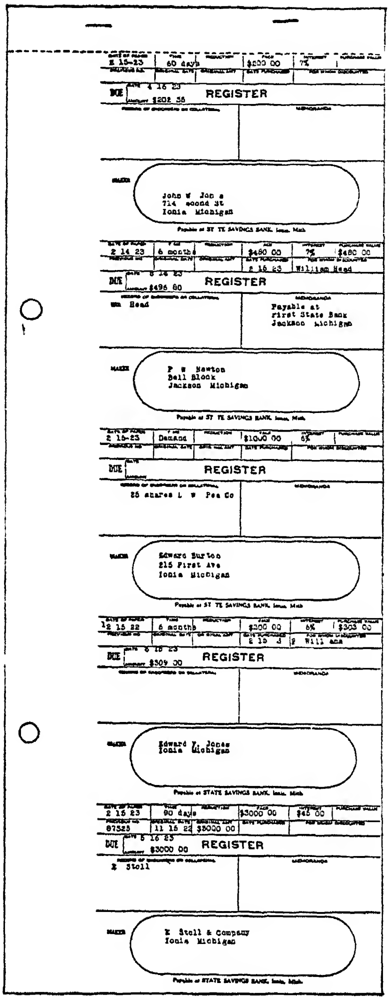
The records of this system are provided by a five-sheet manifold set of forms comprising Discount Register, Direct Liability, Note Notice, Maturity Tickler and Endorser's Liability Sheet. A distinctive color of paper for each ticket in the set makes identification easy in daily use and filing.

The description of five notes may be entered on each set. If it is necessary to remove the form from the machine before completing all five entries, the blocking and wire stitching permit them to be re-inserted without spoiling the registration of the forms. The blanks are consecutively numbered in quintuplicate and each note recorded is tied up in a complete record. All sheets carry the same information as to the history of each note.

When all new notes have been entered for the day the general debits are obtained by totalling the amounts on the Discount Register Sheets. These sheets are then filed in the register binder. This is the combined numerical register and daily journal of all loans made. Card drawers are used for all the other records which tear apart to size 4 × 6.

The liability record slips are filed alphabetically under the names of the maker and endorser respectively, thus the records of all classes of liability for each name are kept in one place.

The maturity slips are filed strictly by due dates of notes, behind month and day guides. *Note Notices* are attached to or filed with the maturity records. These are sent out a week or ten days in advance of their maturity.



2 15-23 | 60 days | $200 00 | 7%
DUE Date 4 16 23 Amount $202 35 REGISTER

John W Jon s
714 econd St
Ionia Michigan
Payable at ST TE SAVINGS BANK, Ionia, Mich

2 14 23 | 6 months | $480 00 | 7% | $480 00
2 16 23 | William Head
DUE Date 8 14 23 Amount $496 80 REGISTER
Wm Head
Memoranda: Payable at First State Bank Jackson Michigan

P W Newton
Bell Block
Jackson Michigan
Payable at ST TE SAVINGS BANK, Ionia, Mich

2 15-23 | Demand | $1000 00 | 6%
DUE REGISTER
25 shares L W Pea Co

Edward Burton
215 First Ave
Ionia Michigan
Payable at ST TE SAVINGS BANK, Ionia, Mich

12 15 22 | 6 months | $300 00 | 6% | $303 00
2 15 3 | F Will ams
DUE Date 6 15 23 Amount $309 00 REGISTER

Edward V. Jones
Ionia Michigan
Payable at STATE SAVINGS BANK, Ionia, Mich

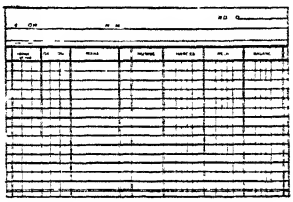
2 15 23 | 90 days | $3000 00 | $45 00
87525 | 11 15 22 | $3000 00
DUE Date 5 16 23 Amount $3000 00 REGISTER
E Stoll

E Stoll & Company
Ionia Michigan
Payable at STATE SAVINGS BANK, Ionia, Mich

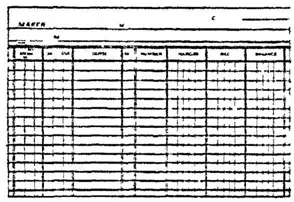
FORM 49 —The Note Register Record   Five notes to a page   Stub at top tears off   Register sheet, 20 inches long, 8 inches wide, is filed in binder

As notes are paid the Maturity Tickler Slips are removed from the file, canceled and passed on as credit slips. Maturity slips for notes not paid when due are transferred from the "Maturity" section to the "Past Due" section of the file, with all of the other past due copies.

Maturity slips representing notes payable on demand are filed behind a "Demand" guide



Endorser's Liability Card



Maker's Liability Card

FORMS 50 and 51 —Line Cards for Active Borrowers Tickets for direct and indirect liability, of every active borrower only, are posted to these cards, saving bulk in the file and giving quick information as to total liability, both direct and indirect

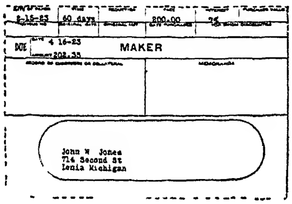
Dealing with Accounts of Active Borrowers and Endorsers.—On very active names in the loan and discount department it is desirable to have total "Line" cards for both the direct and indirect liabilities, showing the total balance against each active customer at any time. As notes affecting these names are entered or paid, the individual amounts on the liability slips will be charged or credited and the balances extended on these cards.

This recapitulation and daily extended balance makes it unnecessary to run through a number of slips to ascertain the total liability for a certain name.

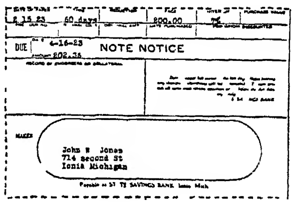
Putting Credits through When Notes Are Paid.—As the notes are paid, the Maturity Tickler Slips are canceled and passed through as credit tickets. A list

of all canceled slips for the day gives the total of notes paid and interest collected for the journal entries.

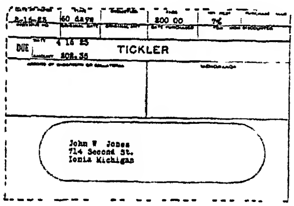
Before filing these tickler slips, reference is made to the Discount Register Copy and the disposition of each note is entered on it.



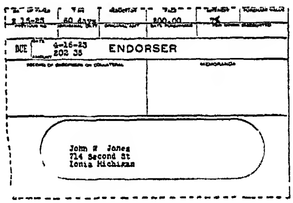
FORM 52 —Direct Liability Record Filed alphabetically by name of maker, with any other tickets for same name



FORM 53 —Note-notice Filed according to the date on which note is due



FORM 54 —Due Date Tickler Filed with note-notice by due date Notice is pulled and mailed Tickler remains in file to warn against past-due notes



FORM 55 —Endorser's Liability Record. Filed alphabetically by name of endorser, with any other tickets for same name

Canceled Maturity slips are then filed away in order of dates paid and thus become the permanent daily journal of notes paid

The direct and indirect liability slips for notes paid are removed from the current file, canceled and filed in strict alphabetical order in a storage container, becoming the transfer liability ledger

This simple system establishes a complete record-control on Loans and Discounts.

The Discount Clerk.—The work of the discount department, or the discount clerk, or note teller, by whichever name he may be called, is purely mechanical. He does not decide who shall have discounts, or upon what terms; he makes the bookkeeping entries after the loans have been passed upon by other officials The work of the discount clerk may be classified as follows

1. Timing the note according to rules found below.
2. Calculating the discount and net proceeds.
3 Making the credit ticket for the borrower's account
4. Entering the item into:
   (*a*) Discount register which records all notes discounted by the bank.
   (*b*) Liability book which records the liability of each borrower, both as maker and as indorser.
   (*c*) Maturity book or tickler which records the notes according to their due dates.
   (*d*) Filing the note in the note files, according to due date.
5. Collecting maturing notes
6. Attending to rediscounts.
7. General statistical work of the department.

Timing Notes.—In order that all instruments which have in them the element of time may be presented at the proper time, it is essential that the time of their maturity be correctly computed. This is called "timing." It is quite customary for each bank handling the item to check the timing calculations. *In timing notes, according to the Negotiable Instruments Law, the day of date is excluded, and the day of payment is included*

Instruments are drawn payable:

1. At *sight*, or on presentation, or on demand.
2. A certain number of days or months after *sight*
3. A certain number of *months* from *date*.

4. A certain number of *days* from *date*.

5. At a specified future time.

The following rules are universal in this country.

1. Where the note falls due on Saturday, Sunday or a legal holiday, it is due on the next business day.

2 Where Saturday is a half holiday, demand notes *may be* presented before twelve o'clock

3. Notes payable a certain number of months after date are payable on the same day of the month indicated. Thus a note dated Sept. 15 at three months is payable Dec. 15, provided the fifteenth does not fall on Saturday, Sunday or a legal holiday. A note payable ninety days from Sept. 15 is due Dec. 14.

When the time has been determined, the discount may be figured.

Figuring Discount.—Banks compute interest on notes (which becomes the discount) from the day of discount to maturity, including Sundays and holidays. The day of date is excluded and the day of maturity included. It becomes necessary to determine the exact number of days the note has to run. This may be done by computing the days in the current month, adding the number of days in succeeding months to maturity. This is too long a process for practical use, and calendars have been devised which make instant calculation possible. Each day of the year is numbered, and by taking the number of the date of discount from the number of the date of maturity, the number of days intervening may quickly be determined.

The great majority of notes discounted are for a sum certain, and do not carry interest, unless so written. *Therefore a note does not carry interest unless so expressed in the instrument itself.* Where the note is written "with interest," it carries interest from its date to maturity at the legal rate; if at a lesser rate it must be so stipulated.

Notes which carry interest must have the interest added and the sum of the face of the note plus the interest becomes the amount at maturity. Discount is figured on the *full amount* and deducted, which gives the proceeds. This would seem at first glance to make the proceeds the same as the face of the note, but many such notes are discounted after their date, which makes the interest larger than the discount. In other words, the interest is figured from the date of the note and the discount is figured from the day of discount.

The old 6 per cent method is useful where it is easily applicable, but for odd days, odd rates, and odd amounts, care must be taken or confusion will result. A much better rule, and applicable to all rates, all amounts and any number of days is:

Multiply *Amount* by *number of days* by *rate*
Divide by 360

Expressed mathematically

$$\frac{\text{Amount} \times \text{number of days} \times \text{rate}}{360}$$

Applied to an example

$$\frac{\$5{,}000 \times 90 \times 06}{360} = \$75$$

Proceeds $5,000 − $75 − $1 stamps = $4,924

Journal Entry

Debit	Notes discounted	$5,000	
Credit	Customer		$4,924
	Discount		75
	Stamp account		1
			$5,000

Interest tables are also used very largely, which merely require the finding of the proper pages and columns. Some banks will not permit the use of interest tables at all, preferring to train their men in the use of mathematics independent of such tables. It is the author's judgment that a bank clerk should first learn the principles of interest calculations so that any problem may quickly

and accurately be solved. After becoming proficient in this work, the tables may be used as a time saver.

After the discount process has been completed, tickets are made in triplicate. One goes to the bookkeeper for credit, one to the customer as advice for his records, one accompanies the note through the records when it is filed for reference.

Exchange Charges and Documentary Stamps.—In certain cases there will be exchange charges for collecting the note at maturity, particularly an out-of-town item. These may be deducted at the time of discount, or charged back at maturity. The revenue laws of the United States levy a tax on all time instruments of 2 cents per hundred dollars or fraction thereof. These stamps must be affixed to the note at the time of discount[1] and cancelled. This amount may be included in the discount and credited to stamp account. This, however, makes numerous small entries on the books and the stamp account may have one entry put through representing all discounts made for the day. In some banks the stamps as bought are charged to income account, and the amount of stamps for each note added to the discount, which is credited to the same account, which automatically credits back the stamp charges. The accounting for stamps in this manner would not properly be a charge against income and would represent an unwarranted deduction from earnings; but the convenience of the procedure is sufficient to warrant breaking an accounting rule for the sake of eliminating needless work, and accomplishes the same result in the end.

[1] The law requires that stamps be affixed at the time of issue, but as a matter of practice they are affixed at the bank where discounted or collected.

In order to check the accuracy of the discount transactions, the work is reviewed by another clerk, either before passing through the records or subsequently

Note Teller.—The work of the note teller varies according to the size of the bank. In a large bank he will handle only the notes of the bank held under discount. Where the lines of discount are large, the bookkeeping of the loans will be heavy enough to employ several men, for it consists in recording the details of each note discounted, the entry into the maturity book and also in the liability book. In addition to the bookkeeping there will be the collection of the notes as they mature. This work includes notes payable in the place where the bank is located and notes payable out of town.

The work of collecting notes of customers, presented to the bank for collection, and drafts drawn on various firms and corporations by the customers of the bank, and left with it for collection, more properly comes under the head of collections and will be found treated at length in Chapter XV. The same comment applies to instruments received from correspondents and other sources for collection.

Where the bank is highly departmentalized the work of the note teller will be complete in itself. He will have his own organization and make his own proofs The total of his receipts will be turned in to the receiving teller or paying teller as the case may be and charged to the one receiving the same.

In addition to the above the note teller in some instances also has charge of the following:

1. General charge of the messenger force used in making collections.
2. Issue of certificates of deposit.
3. Transfer of funds by telegraph.
4. Receipt of registered mail.

5. Delivery of valuable papers.
6. Collection of exchange from customers
7. Collection of interest on loans.

Inasmuch as the various matters mentioned above are treated separately in various parts of this work, we confine ourselves to the work of the note teller as respects the handling of notes held by the bank under discount and those received from customers for collection.

Discount Register.—The note teller will have a record of each note discounted, giving the following details. Date of discount, date of note, maker, indorser, time to run, maturity, amount, discount and net proceeds. The total notes discounted each day will be charged to "Loans and Discounts" on the general ledger and the amount paid will be credited to the same account

Maturity Tickler.—There will also be the maturity tickler giving the expirations day by day, so that proper attention may be given to the maturing notes This book is highly useful in that (*a*) Notes may be presented on their due date to the parties obligated thereon and, if not paid, protested according to law; (*b*) the officers may know from day to day how much paper is maturing, so that new loans may be made as the old ones are paid off.

Liability Book.—The liability book gives the total loans made to each borrower direct and indirect, so that the officials may know how much the borrower is indebted, and that the note teller may keep him within the prescribed limits as laid down in the law and as set by the bank officials.

Collection of Notes for Customers.—The collection of promissory notes differs in no essential from other collections. Such items are time items and receive the same treatment as other time instruments. The work is generally done by the note teller. He performs many other functions beside the mere custody and collection of

notes and acceptances. In the larger banks he will receive the time items from customers, drafts, coupons and collections in general and whatever the customers of the bank may deposit for collection as distinguished from immediate credit. If he is the receiving reservoir for such items, he passes them along to other departments for attention after receipting for them to the customer. There will be three general classifications:

NOTICE OF NOTE FALLING DUE at

COMMERCIAL BANK

192

Please take notice that your note for $. becomes due and payable at this bank . 192

Please observe request stamped hereon and attend to the same before the due date COMMERCIAL BANK

Mr

FORM 56 —Notice of maturing note

1. Items payable in the city—to the city collection department.
2. Out-of-town items—to the country collection department
3. Coupons—to coupon department.

After the item has been timed and entered on the note collection register, carbon forms are made out These forms contain, date received; from whom received; date of owner's letter, when payable; place payable, amount; correspondent bank's collection number; fate, and special instructions.

There are several carbons: (*a*) Going to owner when collection is made as an advice ticket, (*b*) to bookkeeping department as a credit to customer, (*c*) to owner's file, which represents all the items received from the customer (this is useful in tracing items, and also shows the volume received from various customers); (*d*) to maturity file, wherein are classified the items according to due date This shows when items should have attention. Some banks carry this information in bound books It is a matter of choice.

The notes are then filed in the note files according to due date. This may be classified into notes payable in the city and outside, to facilitate the collection process Herein the instruments lie until their due date arrives when they are given attention; and in the case of out-of-town items, they are sent forward in time to effect collection at maturity.

Notes which are held under discount and payable at his own bank are charged to the maker on their due date. Those payable at places reached by the messengers are collected by hand, similar in manner to other collections, and with the same records. Notes payable out of town are sent forward about ten days in advance of their maturity with a collection letter describing the item by number, maker, date, place payable, amount and due date. A duplicate of this form is sent with the instrument to be signed and returned as acknowledgment of its receipt.

The teller's proof consists in a record of notes maturing each day. As payments are received or notes are "charged out" to other departments, proper notation is made, so that at the end of the day the note teller will have cash and checks amounting to the notes which have been paid, and charge entries for the balance. The notes which are not paid are still held by him and entered

as past due paper and either held as such or turned over to the collection or attorney's department for further attention In the large banks all such past due paper is taken out of the teller's work and given special attention by an officer delegated to such work.

Work of the Loan Clerk.—The loan clerk as a general rule has charge of the collateral loans. Where the volume is large there may be several divisions of the work in charge of various individuals who give attention to one class of loans. This work has one attractive feature in that, in due time, it brings under the attention of the loan clerks all kinds of stocks and bonds and all classes of commodities, thereby giving them a valuable knowledge of security and commodity prices and the market movements. It is a valuable training school.

The work of this department, or loan clerk, consists of.

(*a*) Examining and passing upon collateral. This includes an examination as to its form, and the market value.

(*b*) Watching the margin, which means constant oversight of the current values and the relation of the amount loaned to the market value

(*c*) Releasing one kind of security and accepting other kinds—commonly called *substitutions*.

(*d*) Computing and collecting the interest.

(*e*) Collecting such loans as are called or mature.

(*f*) Keeping the loan records.

Collateral.—Collateral consists of two general classes. (*a*) Listed, and (*b*) unlisted. The former includes stocks and bonds which are traded in on stock exchanges the market value of which can readily be determined and sales quickly made if necessary. The New York Stock Exchange, being the largest and most active

in the United States, becomes the trading center of the country, but other exchanges have a large number of listings not found in the New York quotations.

Before a security can be traded in on the New York Stock Exchange, and others as well, it must meet certain requirements and be accepted by the Board of Governors of the Exchange. The company must file extensive data on its business, periodical reports, and submit to other tests as to regularity of operation. It by no means follows that all the good securities are listed, for this is not the fact, there being many high grade securities not traded in on any exchange; but listing with a recognized exchange has the advantages of publicity, a ready market and daily quotation of values In New York, besides the New York Stock Exchange, the recognized leader in this country, there are the Consolidated Exchange and the Curb Market, now housed in a building of its own instead of doing business on the street as formerly obtained. In addition there are the cotton, coffee, and grain and produce exchanges, etc dealing in their respective commodities.

Unlisted Securities.—There are many stocks and bonds of high intrinsic value which are not listed on any exchange, nor actively bought and sold. Their market is limited Banks do not freely accept such securities, and when accepted, their value is determined from private sources or first hand knowledge For instance, bank stock is as a rule unlisted. Many bank stocks are exceedingly valuable but have a limited market. A few are actively traded in in New York and quoted constantly. Some brokerage houses have departments that specialize in bank stocks. The market for such stocks is local as a rule, and the value is determined more often from the statements than from sales, which are infrequent. The dividend rate is also a large factor

in determining the market value. Thus, a stock paying 12 per cent yearly would, as a rule, have a market value of $200 a share, 6 per cent being the basis of reckoning income values The book value may be in excess of this figure and the market value may be still higher if the bank is making money and building up its surplus and undivided profits.

The most troublesome kind of unlisted collateral is that of local companies and particularly land companies whose operations in real estate form the basis of stock issues As a general rule such stocks have no market and very often little or no intrinsic value, there being exceptions to this as to all other rules.

Valuing Collateral.—In determining the value of collateral, the loan clerk will rely first upon the daily papers which publish the quotations of the several stock exchanges. He must know where to look for various securities. Not finding the quotation in the paper, he will turn to the "Stock and Bond Quotation Section" of the *Financial and Commercial Chronicle,* published monthly, which gives the bid and asked prices of a very large number of security issues. It covers the field most thoroughly although not completely. Herein the securities are classified into: Steam railroad bonds; steam railroad stocks, public utility bonds; public utility stocks; industrial and miscellaneous stocks and bonds; municipal and government bonds; foreign government bonds, bank, trust company and insurance stocks, etc. One must know in what class to look for quotations

Failing to find the security listed in the *Chronicle,* the loan clerk or bank officer will make inquiry of some bank in the vicinity of the property or fall back upon the Dun or Bradstreet agencies for reports of condition. A bank checking usually brings satisfactory results, and

if some bank is not able to give an opinion or a quotation, it is a good security to leave alone.

For instance: The bonds of a trolley road in New York State are offered as collateral. They are neither listed nor quoted. The coupons are payable at a certain trust company in Rochester. We assume the trust company to be familiar with the affairs of the company and the quotations on its securities. By writing the trust company we get an opinion that will be a safe guide in loaning thereon. The only market for these bonds may be in Rochester and vicinity. Again: In a certain loan there was a block of stock of a western manufacturing company whose name will frequently be found in the advertising columns of the monthly and weekly magazines. The only market for the stock is among the officers and stockholders of the company, but the stock is exceedingly valuable and is eagerly sought after by those on the inside. A letter to the company or the home banks will bring favorable information regarding this stock.

Mixed Collateral.—Banks prefer to have the collateral to a loan "mixed"—that is, of more than one kind of security. These classes are commonly called "rails" and "industrials" The former includes all kinds of railroad securities and the latter public utility and industrial companies. Banks make their own rules regarding the proper proportion of each class, and where rails are favored, such loans are given a lower rate than an industrial loan. Banks favor a miscellaneous lot of good securities as collateral rather than a loan on collateral of one kind. In case of sale, the latter process might throw on the market more than it could absorb and depress the price, while the sale of a miscellaneous lot of securities would have no material effect on prices No rules can be laid down in this respect, each loan stand-

ing on its own merits, and each bank making its own regulations.

Substitutions.—In all collateral loans, the borrower is permitted to withdraw securities and substitute others of like or greater value. This feature is especially true of stock exchange loans made in the money centers. The brokers may sell any or all of the securities pledged with the bank, take them out of the loan for delivery purposes and keep the loan alive by substituting others. In a rising market the broker may withdraw securities without making payment, inasmuch as the margin grows greater as the securities become more valuable and the bank will be satisfied if a margin of 20 per cent is maintained. Substitution slips are sent with the new securities, giving the name and number of shares or bonds withdrawn, and the name and number of shares or bonds substituted and the amount of the market value. A bank should always be in position to account for all securities handled by it, therefore no security should ever leave its hands without proper voucher.

Some loans are so active and the collateral is changing with such frequency that the exact status of the loan cannot be known without frequent checking. Once a week or oftener such loans are examined as to the character of the collateral and the margin. If not up to the bank's requirements the borrower is required to make such changes as will accomplish the purpose.

Substitutions are recorded on the cards and in the loan ledgers. Collateral released is so marked, with the date, and new collateral is added at the bottom. It often becomes of considerable importance to trace the course of stocks and bonds through the bank and to identify certain securities in connection with loans. Bank auditors as a rule require proof of the withdrawal of collateral by receipt of the borrower or his order

directing the disposition of the securities. All collateral received must be accounted for, either by delivery on the customer's order or sale. Otherwise collateral might easily be taken out of loans by abstracting clerks and used for their own benefit.

The Margin.—In making collateral loans little regard is paid to the status of the borrower, reliance being placed in the security pledged. It must therefore follow that the security of the collateral is paramount. To this end, collateral loans are "margined" by lending only a portion of the value of the securities pledged. Margin may be defined as "the excess of the market value over the amount loaned." This margin is usually 20 per cent or, to put it reversely, banks lend up to 80 per cent of the market value of securities, except in government issues, where only 10 per cent margin is required. In carrying loans for dealers in municipal bonds, banks will lend as high as 95 per cent of the market value for short time loans. The loans are checked over frequently, especially in a falling market, and if the margin is impaired, more collateral is called for or a reduction in the loan is required. The loan clerk has constant care over this point. It is important.

In lending upon unlisted securities, a larger margin is required in order to allow for the slow realization in case of sale. From 60 to 75 per cent on unlisted collateral would not be unfair to the borower and as a rule safe to the lender.

In the large banks a ticker service is maintained and the quotations are watched with care, especially in a falling market. When the margin shows depletion, margin calls are sent out in the evening and made good the next day.

Good Delivery.—In accepting stocks and bonds as collateral, the bank must be in position to sell the same

if the loan is called or the margin becomes depleted. They must therefore be in proper form for delivery. This is called "good delivery" and good delivery means in such form as to pass on the stock exchanges, particularly the New York Stock Exchange. Therefore:

(*a*) Coupon bonds are good delivery without any accompanying instruments The coupon next due must be thereon.

(*b*) Registered bonds must be indorsed and witnessed, and the indorsement must be by the registered owner. As a rule this is done by a power of attorney in blank, registered bonds not having a place for assignment of the owner's interest.

(*c*) Stocks must be indorsed in blank on the back exactly in the same name as appears on the face. This must be witnessed, and should be *in blank*

(*d*) Stocks in the name of deceased persons will require certificate of appointment of the representative In New York consent of the State Tax Commission to make the transfer is also required, and the signature of the executor, administrator, trustee, etc., should be authenticated.

(*e*) Stocks in the name of societies, lodges, etc., will require resolution to sell duly adopted and attested by seal and the secretary.

(*f*) Stocks in name of corporations will require resolution of the Board of Directors, duly passed, with quorum present, and attested by proper officers, giving other officers power to make the transfer.

(*g*) Non-negotiable instruments, such as mortgages, will require *assignment.*

(*h*) Frequently it is required that the signature be guaranteed by a bank or a brokerage house.

Bookkeeping of the Loan.—The collateral loan is evidenced by a collateral promissory note, loan agree-

ment, day loan agreement, etc. The collateral is enclosed in a loan envelope which has on the outside Name of borrower, date, rate, maturity and list of collateral with market values.

The loan is credited to the borrower's account by credit ticket and charged against loans, classified if desired, on the general ledger. The loan is next entered in the collateral loan ledger under the borrower's name. The information taken is: Maker, address, date, rate, maturity, list of securities, par value, amount loaned, market value, taking with the name enough to identify the issue, such as "New York Central Debenture 6s of 1941" with their numbers, and not merely "New York Central Bonds" of which there are several issues After filing the envelopes in the security loan files, the bookkeeping is complete except as to collection of interest. This is done at stated periods, monthly, quarterly, etc., and always when the loan is paid Loans should be checked from the vault to the loan register by one who does not make the book entries, and examined as to good delivery, execution of note, and details of the loan. In no case should the loan papers and collateral be under control of the loan clerk after the loan is made part of the bank assets.

Loan Cards.—Many banks use loan cards in addition to the loan ledger. The card contains a record of the transaction from inception to finish. On it are recorded the details of the loan, changes in collateral, rate of interest, etc. This acts as a check upon the window men in listing, appraising, extending, etc. and also upon the clerk handling the loan register. Cards of different colors may be used to distinguish the various classes of loans, making it easy to verify the amount out on each class.

Loans Made Journal.—The "loans made" journal is a book which records the loans as made seriatim. This book contains the consecutive loans by name, and amount under the proper classification, as Demand, Time, Demand Street, etc., so that at the end of the day each class may be charged with the amount advanced. The credit side will account for the proceeds of each loan, as credit to borrower's account, cashier's check, renewal, etc.

Loans Paid Journal.—As there is a book recording loans made, so there will be a loans paid book to keep account of loans paid off. It is sufficient to record the name of borrower, loan number, rate, amount and account to be credited; and contra, the account to be debited. The book may be ruled for the various classifications in vogue, showing the loans in each class paid from day to day.

Loans for Correspondents.—Call loans afford an outlet for the investible short time money of the country banks. These banks find themselves in funds at certain times of the year, which cannot be placed in permanent investments, or even loaned out for a stated period. The demand for the return of the funds to the depositors may come at any moment or may be anticipated. In order to be in readiness to make such payments, the country banks place the funds out on call through their city correspondents. The latter act as agents on behalf of their customers in making the loans, charging the account when the loan is made and crediting the amount when the loan is called. The collateral is held by the city bank for the account of the country bank, interest is collected and all details attended to as if the loan were their own. For this service no charge is made in certain banks, while in

others a small fee, usually one-eighth of 1 per cent, is charged as a service fee.

Participations.—In making such call loans, the city bank will often sell a "participation" in a call or street loan to a country bank. This means that the country bank takes a part of the loan with some other bank. The city bank holds the collateral for the joint protection of both institutions. The process of making a call loan on a participation basis may best be seen by illustration.

New York is the only place where money in any quantity can be loaned at all times at some rate. This is due to the fact that the stock exchange operations of the New York brokers seem to have an insatiable appetite for money, and the demand is never fully satisfied, although at times the rate may be as low as 1 per cent for call or street loans.

The First National Bank of Smithville has received a deposit of $100,000, the proceeds of a bond issue, sold for the purpose of erecting a public school. The contract has been awarded and it is known for a certainty that the money will be withdrawn during a period of six or eight months. It would be unwise to purchase bonds with this money, for when it is needed the market may be depressed and a loss result. At the same time, the bank has agreed to allow a nominal rate of interest on the deposit, and must reimburse itself by investing the funds in some manner. It decides to purchase $50,000 of commercial paper maturing in six months, to provide for the last amounts to be drawn, and places the balance "on call" in New York. It will notify its New York correspondent to "loan for our account, fifty thousand dollars, and charge our account." In a day or two it will receive a letter stating

ADVICE PARTICIPATION COLLATERAL CALL LOAN

Acting under your instructions we have to-day charged your account $15,000 for a participation sold to you of like amount in call loan to Doe & Co dated 1/15/23 for $300,000 at 4½ per cent, secured by collateral having a present market value of about $360,400

We hold the note or agreement evidencing the loan and the collateral for account of all participants, pending payment

Subject to your further instructions, our understanding is that upon payment of this loan you authorize us to reloan a like amount for your account on call by way of participation or otherwise, also that we are authorized with respect to any loan in which you may have an interest, in our discretion, without advice to you, to call the loan, to change the rate of interest and to allow withdrawal of collateral with or without substitution, and in case of non-payment to sell the collateral

This participation is sold to you without recourse to us other than to account to you for your pro rata share in the proceeds of the loan and interest when paid or liquidated

While we endeavor to exercise care in the handling of all loans of this character we assume no responsibility beyond that of good faith

As compensation for our services in handling the loan you agree to pay us at the rate of ⅛ per cent per annum upon the face of the loan

Please sign and return to us the enclosed confirmation

Very truly yours,

Cashier

The country bank will open a loan account with John Doe and Co., placing as collateral the certificate of the New York bank. When the interest is due on this loan, the New York bank will collect from Doe and Co and credit the First, Smithville. If the loan is paid, another will be substituted. Inasmuch as the interest rate on such loans changes frequently, the city bank will notify the country bank as soon as any change in interest rate takes place, so that the computations may be checked up.

The first payment on the contract becomes due and check is issued by the school authorities for $50,000. The bank is not prepared to meet this at the moment, but calls up the New York bank and advises the latter to call the Doe loan and credit their account.

Doe and Co. are notified to pay the loan immediately, or it is taken over for some other bank having short

time funds for loaning purposes. The city bank will credit the country bank $50,000 and interest to the date of payment and with this credit the $50,000 draft of the school district will be met.

The Money Market.—The "money market" is the available loanable funds held by the banks. The principal market is New York and the center is the New York Stock Exchange. There are money brokers who represent the banks in lending in the open market and who act as the intermediary between the banks and the borrowers. The money brokers have their stated places on the floor of the stock exchange. Some banks have their own broker who represents the particular bank. As soon as the banks have received their clearing house exchanges for the day they know their loanable position. The money market opens at eleven o'clock, when the banks and the brokers meet at the money table in the stock exchange. The brokers' needs have been listed with the money brokers beforehand, and the demand for money is fairly well known before the money market begins to function. Having had an hour of stock exchange operation as a guide, the activity for the day can be approximated and provided for The basis of the market is the loan rate of the day before Money will be offered by the banks at one rate and bid for at another by the brokers. As loans are placed the banks are notified and the loan papers with collateral are sent to the banks and cashier's checks received in payment. About noon the prevailing rate has been established sufficiently for the stock exchange officials to send out an official rate which constitutes the *renewal* rate for the day. As soon as this news goes out over the ticker, the loan clerks in the banks will raise or lower the rates on their call loans made to brokers and notify their clients in case of change.

Banks are not bound to observe the official market rate, and may make any rate they choose. A bank would not naturally cut into the market rate unless it had an abundance of funds, in which case it would establish the market rate, if large enough to do so One large bank in New York prides itself that it has never quoted more than 6 per cent to anyone, no matter how high the market rate might rise. The renewal rate is, however, generally the prevailing rate and is quoted in all newspapers publishing Wall Street quotations. Banks holding call loans for correspondents advise them of any change in the rate. The renewal rate is for one day only, as is also the market rate. It is not customary for banks to change the rate on regular loans to customers and the foregoing applies to brokers' loans only.

In a tight money market the brokers will bid rates up and the banks will offer money high, so that the demand and supply of loanable funds is the regulating factor. The rates are also fixed at different figures according to the class of collateral, and in making these loans the money brokers and stock exchange officials may apportion the funds among the borrowers. Loans are usually made in round sums of $50,000 and $100,000, but may be in any amount agreed upon between the parties. The quotations are for lots of $50,000 as a rule

With the power to fix the interest rates for Wall Street loans, it follows that the money lenders can create any desired situation by raising or lowering rates. By raising rates they can check borrowing and increase the profits of the banks, and by lowering rates they can stimulate borrowing and security buying.

After fixing the renewal rate, unforeseen happenings may reduce or increase the rate for new loans, and the money market changes as frequently as the need for loans manifests itself. It by no means follows that money can

be borrowed at the renewal rate during the rest of the day, and the brokers will ask whatever the borrower will pay.

The right to call loans up to one o'clock has an important bearing on the money market rate If a large amount of loans were called during the day, the brokers would have to pay whatever was asked; and these calls may not come in until after the renewal rate has been established A lowering of rates may come from advices from interior banks to place money on call for their account, after the market rate has been fixed. A rise in rates may come from a large calling in of loans by correspondents. The rate for street loans rose as high as 127 per cent on Oct. 29, 1896. During 1920 the rate rose as high as 30 per cent, but as a rule call money rules below 5 per cent and at times has been as low as 1¼ per cent

The high rates above mentioned would be usury were it not for a provision in the New York law which allows the borrower and lender to agree upon any rate they may see fit, provided the loan is payable on demand, is secured by collateral and the amount exceeds $5,000. Under this law call loans in Wall Street carry whatever interest the parties consent to without becoming usurious.[1]

Time Loans and Rates.—The rate for time loans is usually higher than for call money. These rates are fixed by the banks working with other money brokers who make a business of obtaining money for stated periods, usually under six months. The broker is willing to pay a higher rate for the certainty of knowing what the rate will be and that his loan is safe for a definite period. The bank in substance charges a premium for foregoing its right to alter the rate and take advantage of a rise in the market. The fluctuations in

[1] Sec 115, New York Banking Law

time rates are nominal. The rate for commercial paper follows closely the rate for time loans, since this form of paper runs from four to six months and is essentially a time loan.

Interest Rates.—The general agreement in call loans is to the effect that the borrower will pay the daily renewal rate as long as the loan runs, unless it was made at a flat rate when accepted; but such loans are usually on a time basis. Special agreements may be made as to the rate, some banks refusing to charge their customers the going rate when it soars beyond a certain point. When the rate is changing frequently, the borrower is notified of each change of rate, which is marked in his ledger account for computation purposes.

Collection of Interest.—By custom in New York borrowers on call loans pay interest monthly. Statements are sent to borrowers and settled for by check or charged to the account. Coupons on bonds held as collateral are collected by the bank only when so requested. The coupons are cut, collected and credited to the borrower; or they may be sent to him for like purpose.

Loan Contract.—Instead of signing a collateral promissory note for each loan, the broker or borrower executes a loan agreement which covers all loans made by the bank to him. It is a lengthy document but in substance it gives the bank a lien upon all the collateral for any debt due by the borrower to the bank. It gives the bank the right to sell the collateral to reimburse itself for loans made. It gives the bank a lien upon the borrower's balance. The bank has a right to demand additional collateral and to sell with or without notice at public or private sale any securities held by it to pay any indebtedness, or to make good any deficiency of margin The borrower waives notice of proposed

sale and consents that the bank may purchase the security itself. The loan contract is general and covers all loans and all property in possession of the bank It is a valuable and at the same time a dangerous instrument according to which side it represents.

The Day Loan.—The "day loan" is a device used by brokers who need temporary accommodation from day to day. A quantity of collateral is kept with the bank and covered by an agreement similar to the call loan contract. Under this contract the bank will credit to the account from time to time enough funds to cover the broker's checks which are presented for certification It is contemplated in the day loan that the loan is for a very short period—it may be a few hours—and that the balance shall be restored at the close of the day from the broker's regular deposits. It is essentially a safety device to cover overdrafts, which would occur were not the day loan used to make the drawings good when presented for certification.

It was formerly the custom in Wall Street transactions for the broker to arrange with his bank to certify up to a certain amount during the day to cover his dealings for the day. It was overcertification, and contrary to the law, but widely in use. It was finally prohibited by the authorities as against the law and good banking, and in its place there has arisen a custom of making day loans to brokers.

In the morning the broker estimates his probable needs for the day and executes a note for the amount, with a day loan agreement. Some banks require a deposit of collateral and others loan on unsecured notes of well known houses. The amount of the loan is placed to the broker's credit and certifications are made against it. By three o'clock the loan must be paid or secured by collateral. As a rule no interest is charged on the

day loan, since it does not run a business day. The bank's only profit comes from the actual cash balance carried by the broker

Guarantee of Loans.—It frequently happens that an individual will be willing to guarantee the payment of all paper discounted by another, or a firm or corporation. It would be inconvenient for him personally to indorse all such paper, and he may lend his credit through a guaranty of payment. This is a separate instrument by which the payment of certain specified notes are guaranteed; or the guaranty may be general and cover all loans made to the party accommodated. This guaranty should be drawn by an attorney, and should cover all renewals and extensions of the notes discounted. In short, the guaranty should cover the indebtedness of the borrower to the bank, of whatever nature, up to a stated amount. The guaranty should be renewed from time to time, and it must be understood to expire with the guarantor's death. Where the guaranty is looked upon as the principal strength of the credit line, it should be given frequent and careful attention, lest the guaranty become worthless. *Oral guarantees should never be accepted under any condition.* The statement made by a bank director at one time, that he would become personally responsible for all loans that were introduced by him, was accepted in good faith; but upon seeking to collect upon this statement the bank found itself helpless at a cost of about $10,000.

The Yield Book.—It is helpful if not necessary that a bank know the income from its loans; particularly where the loans are made at various rates. For this purpose the loans are grouped according to interest rate. After this is once established it is an easy matter to keep it up to date. The loans made each day are classified and carried to the yield book and those paid are deducted.

By taking the total loans and dividing this amount into the interest receivable for a day or a year, the average income may be ascertained. This is applicable alike to loans on collateral and on discounts.

Calling Loans.—A call loan is, as its term implies, callable at any time at the election of the lender and is payable at the option of the borrower. By custom loans that are not called before 12.15 in New York are held over until the next day. Loans called must be paid by 2:15. Upon receipt of a certified check and identification of the messenger, which consists of an identification slip given when the loan was made, the collateral is delivered. Time loans are of course due on their maturity date. As a matter of courtesy, and in order to keep the files free from past due paper, banks as a rule send out notices of maturing notes about ten days in advance. They are under no obligation to do this, but experience demonstrates that it is a good policy.

Prepayment of Loans—Renewals.—Loans are frequently anticipated in their payment. These are, of course, time loans. If their payment is anticipated, the bank will refund the interest charged for the unexpired time; but if the prevailing rates are lower than the loan carried when put through, the rebate will be at the current rate. Where a loan is renewed, it is treated as a new loan in the records, and put through as such and so indicated. The old loan or note is cancelled, crossed off the record, and the new note put through. Renewals are generally passed upon by the officials without reference to the committee.

Merchandise Loans.—Any commodity which has a market may constitute the basis for a bank loan; and those commodities which are essential to human life afford collateral that is quite ideal. Of such character are food stuffs, particularly the non-perishable, raw

material such as wool, cotton, rubber, leather, etc. Perishable commodities such as fresh meats, butter, eggs, fruits, vegetables, etc., are good collateral only for a limited time.

In loaning upon commodities, the banks carry the financial load from the time the raw material leaves the grower until the finished product is sold to the consumer. To illustrate: A cotton grower in the South may pledge his crop to a bank before it is harvested. As soon as the cotton is ginned and baled and placed in storage, or on board the car, a warehouse receipt or a bill of lading is issued against it. The bank protects itself by holding the bill of lading or storage receipt. If it goes into the mill, the bank may hold the cotton under trust receipt. When shipped out as cotton cloth, the bank may again receive a bill of lading In the hands of the merchant the cotton cloth forms part of his general assets, pledged against his open line of credit. When the cloth is sold, the bank may receive an assignment of the account against the buyer, and thus from raw material to consumer the bank does the financing.

Rules in Loaning upon Merchandise.—In loaning against commodities the following rules should be observed:

1. The merchandise should have a broad, active and steady market.
2. The quality of the merchandise should be ascertained from inspection or certificate from authorized inspectors
3. The quantity should be accurately determined.
4. The title to and control over the merchandise should be in the bank.
5. The margin should be at least 20 per cent on market values.
6. The market should constantly be watched.

7. A proper amount of insurance should be carried, running to the bank

In loaning upon commodities the bank will have its selection, running from wheat flour to rare and costly drugs, from smoked meats to freshly picked fruit. In making such selection, the market must be considered as the controlling factor, and only such articles selected as will be readily salable at any time, and whose range of prices does not fluctuate violently. In a rising market, such as obtained during the war, a loan on any kind of merchandise grew better day by day, as prices were advancing. But when prices began to tumble with unheard of violence, commodity loans became a menace to those banks which had loaned freely at the peak of prices. For instance, a loan on sugar, at 5 cents a pound, with the market at 6 cents, would ordinarily be safe; and when sugar began to climb up to 20 cents a pound, the loan constantly grew better; but a loan at 20 cents a pound on sugar that was selling at 25 cents a pound might easily and did, in certain cases, cause heavy losses to those banks which were accepting such business. Six-cent sugar is safe sugar, 25-cent sugar cannot last long

There is always the danger that perishable or semi-perishable articles may spoil through lapse of time. Grain will heat under certain conditions; articles in cold storage are governed by food laws, and cannot be kept too long and remain salable. Dampness will destroy leather and other semi-perishable commodities. Therefore constant thought must be given to such loans if the quality of the merchandise is to be kept in condition.

In many lines of industry, qualified inspectors are employed whose certificates are accepted the world over as to the quality of the goods. Thus, grain which is graded at Duluth by expert grain inspectors will be

accepted in any market at the grading established at Duluth. Likewise as to cotton. Being assured of the quality, the quantity may be ascertained from recognized weighers, as in coal, grain, etc., and by measurers as in lumber. If one hundred bales of cotton of a certain grade were to be loaned against, the number of bales could be ascertained by count; the quality by the inspection certificate.

The Margin on Merchandise Loans.—Merchandise loans are made with a safe margin to allow for changes in the market value; and to this end the market must constantly be watched in order that the value of the merchandise may not depreciate to the point of imperilling the loan. A rapid fall in prices will necessitate a reduction of the loan or more collateral. In the deflation period following the war, many banks were caught in the net of a rapidly declining market, and could not obtain reductions in the loans, or more collateral and took heavy losses in consequence. Goods held as collateral were turned over to the banks, or loans were called with no effect, so that many bank officers unwillingly became merchants instead of bankers, trying to work out their loans by sales of goods.

In placing goods in warehouse, insurance is generally taken out, and the policy made to run in favor of the bank "as its interest may appear," which policy should be in possession of the bank. In the case of bills of lading the carrier becomes responsible for the safe delivery of the goods and is also an insurer.

Title to merchandise used as collateral is evidenced by two instruments, (*a*) the warehouse receipt; and (*b*) the bill of lading.

Warehouse Receipts.—In placing goods in storage warehouses, there is issued to the depositor a warehouse receipt, which acknowledges the receipt of the goods

mentioned. This receipt specifies the goods with sufficient clearness to identify them, but does not guarantee quality or quantity. It acknowledges the receipt of "twenty cases of dry goods, said to contain, etc.," and identifies the cases by certain markings. There are two kinds of warehouse receipts, the negotiable and non-negotiable. The former may be transferred by indorsement, and is the kind banks should insist upon; the latter cannot be indorsed and the transfer would have to be by assignment or bill of sale The former carries title to the indorsee upon mere indorsement It has no red tape.

Before the goods are delivered this warehouse receipt must be presented, and if part of the goods only is taken out, the goods released are indicated on the back.

Such warehouses are found in all large cities, and store all kinds of goods. They are carefully managed and the receipt of a public warehouse is equivalent to a guaranty that the goods are in its possession. It guarantees nothing, however, but the possession of the goods. It is not an insurer.

Warehousemen.—A warehouseman is one who is engaged in the business of storing goods for hire. He holds himself out as qualified and competent to store such goods as are entrusted to him and in so doing he is held to the exercise of reasonable care. He does not guarantee the quality or quantity of goods, nor does he insure them against fire or theft; but if he is negligent in providing against such risks he may be held liable. If goods are stolen by thieves and proper precautions have not been taken that an ordinarily careful man would take, negligence would make him liable. If the goods are damaged by a leaky roof, this too would be an act of negligence, but the owner of the goods must protect them from fire by insurance taken out and paid for by

himself. The warehouseman is under obligation to deliver the same articles and in as good condition as received.

The laws of the various states are now quite uniform in their provisions as to public warehouses, and the receipts issued by them are uniform in the same sense as bills of lading and negotiable instruments are uniform. The receipt issued by a warehouse under these rules must contain:

1. The location of the warehouse.
2. Date of issue.
3. The receipt number.
4. A delivery clause stating whether the goods will be delivered to any holder, or to a specified person, or to a specified party or order. The latter is called the "negotiable warehouse receipt" and is the proper one for banking purposes.
5. The rate for storage charges
6. A description of the goods received, specifying the quantity, if in units, or by marks on packages for identification purposes, where the goods are packed.
7. Receipt of goods over an authorized signature.
8. Any liens upon the goods arising by virtue of freight and cartage charges, handling, etc, that would act as a cloud upon the title of the property.
9. Any other statements not inconsistent with the Uniform Warehouse Receipts Act.

Classes of Warehouse Receipts.—Receipts for goods in storage are, as aforesaid, issued in two forms: (*a*) Non-negotiable. Such receipts agree to deliver the goods to the depositor or to a specified person. The goods are therefore not deliverable to anyone but the owner or the designated party. Such receipts cannot be indorsed to others. They fall under the class of restrictively indorsed instruments.

(*b*) Negotiable receipts. These agree to deliver the goods to the party named therein or on his order, and are therefore transferable from hand to hand as are negotiable instruments. Non-negotiable receipts must be so marked Duplicate receipts must be plainly marked so that confusion will not result on account of the two receipts being outstanding.

Delivery of Goods.—Goods in warehouse and represented by non-negotiable receipt are deliverable to the owner, or specified party, upon the payment of all charges against them. When represented by a negotiable receipt they are deliverable as follows:

1. If the receipt is properly indorsed to the holder and the holder can properly identify himself.
2. The charges are paid.
3. The receipt must be surrendered, properly indorsed.
4. The goods must be receipted for when taken out of storage.

The warehouseman is discharged

1. If he delivers the goods to the person lawfully entitled to them and who offers the receipt in due form with indorsements, if the receipt is negotiable.
2. If non-negotiable, the delivery is made upon due order of the owner, the risk of forgery being assumed by the warehouseman. He must hold a bona fide order for delivery.
3. If he delivers the goods to the holder of a negotiable receipt in due course.

The warehouseman is liable to the holder of the receipt if he delivers goods without taking up the receipt. If he delivers part of the goods he must either take up the original receipt and issue a new one for the remainder, or plainly indorse upon the original the goods taken out. The warehouseman in no sense guarantees the contents of packages. The holder of the receipt must

satisfy himself that the goods are therein as contemplated. The goods of each depositor must be kept separate insofar as possible for indentification purposes; but if the goods are of a standard, they may be mingled with other goods of the same kind and grade.

Thus in storing grain, it is obviously impossible to keep the various lots separate. The grain is stored according to grade and the warehousman is under no obligation but to deliver the stated quantity of the same grade. In storing canned goods, for instance, the warehouseman may have a thousand cases of salmon; but salmon is of several grades and special brands. Each grade and brand has a separate value and he must not mingle one lot with another, but must redeliver the exact cases the receipt calls for.

Warehouseman's Lien.—The warehouseman has a lien upon all goods in his possession for all charges that may accrue against them. This includes. Charges advanced when the goods were placed in storage, labor in handling, weighing, interest on money advanced, expenses of notice of sale and commissions on sale of goods in default of storage charges.

A warehouseman may assert his lien by:

1. Giving notice to the person for whom the goods are held and to others known to have an interest in the goods that the claim is about to be asserted. This notice should be sent by registered mail or delivered in person to the parties in interest.
2. A statement of such charges as have accrued.
3. A description of the goods.
4. Demand for reimbursement.
5. Notice that unless claim is satisfied by a stated time the goods will be sold at public auction, giving time and place.

Where goods are perishable and deteriorating, or where leakage or breakage is likely to cause damage to other goods, the warehouseman may give notice of removal within a certain time, upon failure to do so he may sell the goods for account of owner or otherwise legally remove them to another place. Any excess received from sale, over and above the charges and costs, must be returned to the owner.

Transfer of Warehouse Receipts.—A negotiable warehouse receipt is transferable by indorsement and delivery of the receipt It may be indorsed in blank and become a bearer receipt, or it may be indorsed to a specific person who must further indorse it. In this respect it follows the law of negotiable instruments. By such an indorsement the indorser conveys to the indorsee the same title as the indorser had. He also acquires the same rights against the warehouseman and the same liability to him as the indorser had. The transferer of a negotiable receipt warrants:

(*a*) That the receipt is genuine.

(*b*) That he has good title to it.

(*c*) That he has no knowledge of any fact that would impair the validity of the instrument.

(*d*) That he has a right to transfer the instrument, and thereby the title to the goods, that the goods are merchantable or fit for the particular use whenever such warranties would have been implied had the contract of the parties been to transfer the goods without a receipt.

He does not warrant delivery by the warehouseman, but in a sense indorses without recourse, giving his indorser such title as he had in the goods.

Under the Uniform Warehouse Receipts Act it is criminal for a warehouseman:

(*a*) To issue a receipt for goods not actually received or under his control at the time the receipt was issued.

(*b*) To issue a receipt containing a false statement.

(*c*) To fail to mark duplicate receipts as such.

(*d*) To issue receipts for goods owned in whole or in part by himself without stating the fact.

(*e*) To deliver goods without taking up the negotiable receipt issued, thereby leaving such receipt outstanding.

It is also criminal for one to store goods to which he has no title, and to take a negotiable receipt therefor, or to take out a negotiable receipt for goods under mortgage or lien and to negotiate this receipt, without stating clearly the existence of such lien or mortgage. A warehouseman is bound by the acts of his servants and agents.

Trust Receipts.—Changes in the nature of merchandise used as collateral may occur as frequently as in stock exchange loans. Borrowers are constantly trading and find it necessary to take out merchandise of one kind and lodge other commodities or other quantities of the same kind. Warehouse receipts cannot be split up into sections according to the articles covered; but the same purpose is accomplished by indorsing on the back the amount of goods taken out.

Goods in storage are frequently taken out by the borrower upon trust receipt. If he desires a portion of the goods he may give the bank his check or a trust receipt in return for the warehouse receipt. The amount of goods required is then taken out, a new receipt issued and returned to the bank, which turns back the trust receipt or check. Goods are taken out on trust receipt for manufacturing purposes, or for sale and delivery. In such cases a trust receipt is executed which retains the title to the goods in the bank, while allowing the borrower to use the same for specific purposes. He agrees to pay the value to the bank in due course, and the

title of the bank to the material or any products manufactured therefrom remains good until the trust receipt is cancelled. The chief virtue of the trust receipt lies in the fact that it gives the borrower the right to use the goods as trustee, while not surrendering the claim of the bank thereto.

The safety of the trust receipt plan lies in the integrity of the borrower. For any breach of faith he would be legally responsible and to convert the goods to his own use would be a penal offense.

Bills of Lading.—With every shipment of goods, by rail or water, there is issued a bill of lading. This, like the warehouse receipt, acknowledges the receipt of certain goods, but receives them for transportation to a given destination, and likewise identifies the goods, but does not guarantee the quality or the quantity, except as to the number of packages, or the stated number of pieces.

With a Uniform Negotiable Instruments Law, and a Uniform Warehouse Receipts Act and a Uniform Bills of Lading Act, making the laws respecting these instruments quite the same throughout the country, we have a very desirable banking situation. The bank knows that the practices and rules are standardized in the various states. It may therefore handle such instruments in the knowledge that the laws are the same everywhere. In treating the three subjects above mentioned, we are able to do so without qualifying statements as to a conflict of laws between states.

Bills of lading have to do with the transportation of property; and as property in warehouses can be safely pledged as collateral, so property in transit may safely be accepted if accompanied by proper documents in due form. A *carrier* is a person or corporation whose business consists in transporting goods for hire. The

medium may be water, rail, automobile truck or horse-drawn vehicle A *private* carrier is one whose chief business is not the carriage of goods, but who does so occasionally for hire or gratuitously. One whose chief business is to transport goods is a *common carrier.* A common carrier must accept goods tendered to him with the established rates, as long as he has accommodation for the same. He is liable for losses and injuries suffered to the goods while in his possession, except such injuries as are the act of God or of a public enemy, or the owner himself.

He is thus an insurer of the goods He insures their safe delivery and their condition at delivery. The most common of the public carriers are the railroads and steamship lines and this discussion has chiefly to do with bills of lading issued by them.

A bill of lading may be defined as

> A written acknowledgement of the receipt of goods as described by a carrier, and an agreement for a consideration, to transport and deliver the same at a specified place to the consignee designated therein.

Every bill of lading must contain the following:

1. Date of issue.
2. Name of shipper.
3. Place of receipt
4. Place of delivery.
5. Statement as to whether the goods will be delivered to a specified consignee or upon his order.
6. Description of the goods.
7. Signature of carrier's agent.

The acceptance of the bill of lading binds the shipper to the contract of shipment and need not be signed by the shipper.

Bills of lading are classified into "straight" and "order" bills. The former are non-negotiable and contract to deliver the goods to the consignee named. The negotiable bill agrees to deliver the goods to the order of a specified party. The production of the bill is required in the negotiable bill of lading, and is not required in the straight bill. The non-negotiable bill must therefore be marked "non-negotiable" to distinguish it from the negotiable form. The latter is the form commonly used in banking transactions.

On account of the perils of the sea, ocean bills of lading are usually issued in sets, in duplicate, but in domestic shipments duplicate bills are not used. In fact the issue of bills in sets in domestic trade is forbidden. If issued they must be plainly marked as to the duplication.

Liability of Carrier.—A carrier is bound to transport such goods as are offered to it, unless it would plainly be against public policy to do so. Thus it would not be obliged to carry highly inflammable or explosive substances except under certain conditions as to public safety. It would not be obliged to accept a shipment of perishable fruit or vegetables in winter without proper safeguards from frost. Otherwise it must accept what is offered and transport the same to place of destination, insofar as its lines run, and then by connecting line. It must deliver the goods upon demand properly made by the consignee, if a non-negotiable bill has been issued; or, if a negotiable bill has been issued, to the holder in due course, properly identified, provided such demand is accompanied by:

1. Carriage charges.
2. The bill of lading properly indorsed.
3. Proper receipt for their delivery.

Therefore, the carrier can only deliver goods lawfully to:

The consignee named in a non-negotiable bill.
The holder of a negotiable bill properly indorsed.
Any person lawfully entitled to receive the goods.

If the carrier delivers otherwise it is responsible to the true owner. If the carrier delivers the goods and fails to take up the bill of lading it is responsible to any holder of the bill who may present it and have good title to it. If a portion of the goods have been delivered, they should be plainly marked on the bill. It is not the custom for carriers to make partial deliveries, the general requirement being to surrender the bill; and if part of the goods are not desired they may be stored in the company storehouses under a warehouse receipt.

In receipting for goods, carriers are careful not to incur obligations as guarantors of quality or quantity. The bills of lading specify a certain number of packages "said to contain," etc , or a certain *number* of articles, or "shipper's load and count"—meaning the goods have been loaded by the shipper himself and not inspected by the company. The carrier does not guarantee that the goods shall be as represented. It merely agrees to transport them safely to destination.

Such companies are now held to the regularity of bills of lading issued by their agents, and if bogus bills are issued and held by bona fide purchasers for value, the company is responsible for the goods called for, even though they were never received. In other words, the company guarantees the acts of its agents.

The Uniform Bills of Lading Act makes a bill of lading fully negotiable. It is therefore a safer instrument for bank loans than formerly obtained, and bills may be transferred by indorsement and carry good title to the goods represented thereby. The person to whom such a bill has been negotiated acquires: (*a*) Such title to the goods as his transferor had, or had ability to

convey to a purchaser in good faith and for value; and such title to the goods as the consignee or consignor had or had power to convey to a purchaser in good faith for value; and (*b*) the direct obligation of the carrier to hold possession of the goods for him according to the terms of the bill as fully as if the carrier had contracted with him directly.

Transfer of Bills of Lading.—A bill of lading may be transferred by the holder by delivery, accompanied by an agreement, expressed or implied, to transfer the title to the bill or to the goods represented thereby. A person to whom a bill has been transferred, but not negotiated, acquires thereby, as against the transferor, the title to the goods subject to the terms of any agreement with the transferor, and as against third parties he acquires such title as his transferor had. If the bill is non-negotiable such person also acquires the right to notify the carrier of the transfer to him of such bill, and thereby become the direct obligee of whatever obligations the carrier owed to the transferor of the bill immediately before the notification. Prior to the notification to the carrier or transferee of a non-negotiable bill, the title of the transferee to the goods, and the right to acquire the obligation of the carrier may be defeated by garnishment or by attachment or execution upon the goods by a creditor of the transferor, or by a notification to the carrier by the transferor or a subsequent purchaser from the transferor, of a subsequent sale of goods by the transferor. To be binding upon the carrier, the notice must be made to an officer of the carrier or authorized agent and such officer or agent is allowed a reasonable time to communicate with the agent or agents having actual custody or control of the goods. Where a negotiable bill is transferred for value by delivery and the indorsement of the transferor is essential for negotia-

tion, the transferee acquires the right against the transferor to compel him to indorse the bill unless a contrary intention appears.[1]

A person who negotiates or transfers a bill of lading by indorsement or delivery, including one who assigns for value a claim secured by a bill of lading warrants, unless a contrary intention appears.

1. That the bill is genuine.
2. That he has legal title to it.
3. That he has knowledge of no fact that would impair the validity or worth of the bill
4. That he has power to transfer title to the goods and that the goods are merchandisable or fit for a particular purpose whenever such warranties would have been implied if the contract of the parties had been to transfer the goods represented thereby without a bill of lading

Title to Goods Shipped.—It frequently becomes of importance to know who is the owner of goods in transit. The Uniform Bills of Lading Act provides that the form of bill indicates the ownership. Where goods are shipped by the consignor in accordance with a contract or order for their purchase, the form of the bill indicates the transfer or retention of ownership and the right to possession as follows:

1. Where, by the terms of the bill, the goods are deliverable to the buyer or his agent, or to the order of the buyer or his agent, the title is transferred to the buyer.
2. Where, by the terms of the bill, the goods are deliverable to the seller or his agent, or to the order of the seller or his agent, the seller thereby reserves the property in the goods; but if, except for the form of the bill, the property would have passed to the buyer on shipment of the goods, the seller's property in the goods

[1] WESTERFIELD, "Principles of Banking," p 920

is deemed to be only for the purpose of securing performance by the buyer of his obligations under the contract.

3. Where, by the terms of the bill, the goods are deliverable to the order of the buyer or his agent, but possession of the bill is retained by the seller or his agent, the seller thereby reserves a right to the possession of the goods as against the buyer.

4. Where the seller draws on the buyer for the price, and transmits the draft and bill together to the buyer to secure acceptance or payment of the draft, the buyer is bound to return the bill if he does not honor the draft and if he wrongfully retains the bill he acquires no added right thereby.

If, however, the bill provides that the goods are deliverable to the buyer, or to the order of the buyer, or is indorsed in blank or to the buyer by the consignee named therein, one who in good faith purchases for value the bill or goods from the buyer obtains title to the goods, although the draft has not been honored, if such purchaser has received delivery of the bill indorsed by the consignee named therein, or of the goods, without notice of the facts making the transfer wrongful.

Where the seller of goods draws on the buyer for the price of the goods and transmits the draft and a bill of lading for the goods either directly to the buyer or through a bank or other agency, unless a different intention on the part of the seller appears, the buyer and all other parties interested are justified in assuming:

1. That if the draft is by its terms or legal effect payable on demand or presentation or at sight, or not more than three days thereafter (whether such three days be termed days of grace or not), the seller intended to require payment of the draft before the buyer should be entitled to receive or retain the bill; (2) that if the draft is by its terms payable on time, extending beyond three

days after demand (whether such three days be termed days of grace or not), the seller intended to require acceptance but not payment of the draft before the buyer should be entitled to receive or retain the bill.

These assumptions are applicable and valid whether by the terms of the bill the goods are consigned to the seller or to his order, or to the buyer or to his order, or to a third person or to his order.

Where a negotiable bill has been issued for goods, no seller's lien or right of stoppage in transit can defeat the rights of any bona fide purchaser for value to whom such bill has been negotiated; and the carrier is neither obliged to deliver nor justified in delivering the goods to an unpaid seller unless such bill is first surrendered for cancellation. With the foregoing exception, the Uniform Bills of Lading Act does not limit the rights and remedies of a mortgagee or lien holder whose mortgage or lien on the goods would be valid apart from this Act, as against one who for value and in good faith purchased from the owner, immediately prior to the time of their delivery to the carrier, the goods which are subject to the mortgage or lien, and obtained possession of them.[1]

Under the present laws the issue of a bill of lading by any agent, officer or servant of a carrier, with intent to defraud, or who aids in issuing a bill of such character, knowing that all or any part of the goods called for in the bill have not been received by the carrier, or are not under the carrier's control at the time of issue, is criminally liable. False statements made in bills, made knowingly, are also punishable as crimes.

The issue of a duplicate bill, knowing the original is outstanding, unless the duplicate be plainly marked, is also a crime. The same applies to non-negotiable bills not marked "non-negotiable."

[1] WESTERFIELD, "Banking Principles and Practice," p. 921

It is a crime to ship goods to which the shipper has no title or upon which a lien or mortgage exists, and to take for such goods a negotiable bill, which is afterward negotiated for value with the intent to deceive, and without disclosing his lack of title or the existence of the lien or mortgage. Likewise the negotiation or transfer of a bill for value with intent to deceive, knowing that any or all of the goods called for in the bill are not in possession of the carrier or under its control, or control of a connecting carrier, without disclosing the fact, is made a crime. Lastly, the inducing of an agent or officer of a carrier to issue a bill, by false representations as to the possession of or control over the goods by the carrier or connecting carrier, when such possession or control does not exist, is made a crime.

Loans upon Arrival Drafts.—Loans are frequently made against goods in transit. The shipper draws a bill of exchange on the buyer, payable upon arrival of the goods. The bill of lading is attached to the draft and offered to the bank for discount. If the papers are in due form, the bank will advance against the bill, and send the papers to its correspondent for collection. The latter presents the bill to the buyer, who honors the same upon the arrival of the goods. Upon receiving payment, the correspondent will remit to the sending bank, which deducts interest for the time the funds were loaned and the charges for collection, thus reimbursing itself for the advances made to the seller. If the buyer places the goods in storage the bank may loan him the funds against warehouse receipt, thus placing him in position to pay the draft, out of which funds the seller's bank will receive its payment.

Book Accounts.—The most common method of extending credit in the United States is through the medium of the book account, commonly called a "receivable." The

seller opens an account with the buyer and charges him with the amount of the goods purchased. The terms are agreed upon at the time of sale and vary in different lines of merchandising. These terms run from ten to ninety days. In order to induce the buyer to make prompt payment, the seller offers a discount from the face of the invoice for prompt payment. These concessions are expressed as "2/10, 1/30, net 60," which means, that if the bill is paid within ten days of its date, 2 per cent may be deducted; if paid within thirty days, 1 per cent may be taken off; but if it is not paid within sixty days no discount is allowed, and the bill becomes due sixty days from its date.

These concessions are widely availed of, and many firms pride themselves upon taking their cash discounts. It is profitable, and if pursued consistently, will result in a high rating for the merchant as a credit risk. As a matter of fact, no higher compliment can be paid to an American merchant than to state that he always discounts his bills. It puts him in the prompt payment class, where every good merchant aims to be.

In order to take advantage of these cash discounts, many merchants find it profitable to borrow at their own banks on their unsecured notes and to sell their unsecured notes in the open market. The latter is called selling *commercial paper* and will be found discussed under that head. Not only does the buyer borrow in order to obtain the cash discounts, but the seller finds it necessary to borrow also in order to carry his customers during the cash discount period. Therefore the wholesaler carries the retailer for a short period of time, and borrows in order to do so, while the retailer borrows in order to avail himself of the cash discounts offered by the wholesaler, and to carry his customers.

That this is profitable may be seen by example. In buying a bill of goods amounting to $1,000 the buyer has the option of taking $20 off if paid within ten days, or $10 may be deducted at the end of thirty days Assuming that the buyer borrows $1,000 for sixty days in order to take the 2 per cent, his bank loan costs him but $10 and he saves $20 by discounting the bill—a profitable transaction. There are, however, many business men who are short of funds and who are not large enough to sell their paper in the open market and at the same time they have exhausted their borrowing facilities at their own banks. These concerns lack working capital sufficient to handle their business, and as a rule are honest, hard-working and worthy. The necessities of such concerns has brought into existence a large number of finance houses which specialize in making loans on book accounts. They begin where the bank leaves off. Their credit risks are less sound than the banks are willing to accept, but for which they exact their fee. They accept greater risks and exact greater compensation. In a large measure they step in between the bank and business embarrassment and carry the concern through its difficulties. In general these concerns are profitable and will be found in all large cities. This method of operation is not in favor in some banking circles for the reason that the merchant or manufacturer who resorts to this method of borrowing pledges one of the quickest and most valuable of his assets—the book accounts.

The cycle of business in this respect is. Cash into merchandise; merchandise into book accounts; book accounts into cash. There should therefore be a constant stream of money coming into the firm to meet the constant outflow. And if this inflow is anticipated unduly, by selling the book accounts as soon as they are

created, it will have the same effect as drawing water from a reservoir faster than it flows in.

The questionnaire used by bankers in extending credit provides for ascertaining this fact and where the borrower uses this form of finance, it works against his credit standing in the bank. The reason is simple The banker cannot feel sure of his position. The borrower has created a preferred class of creditors and given them the cream while the banker must be satisfied with the skim milk. An example of this form of financing will show the process. The A. B. C. Furniture Company makes a special class of furniture and is a small but wholly reliable concern. It lacks capital to handle the business which comes to it. It receives more orders than it can handle. It works from hand to mouth, and has borrowed at its bank all that good banking can safely lend. It makes an arrangement with a commercial finance house to discount its accounts receivable at the rate of six per cent per annum on the face of the invoice, plus a service charge of $5 per thousand dollars of business.

It has received and filled an order from John Wanamaker for $3,000 worth of furniture, on terms "2/10–1/30–net 60." The goods have been shipped to Wanamaker's and the furniture company holds the shipping receipt. An invoice is made out, attached to the shipping receipt, with assignment of the account, together with such other paper as the lending company may require. This may be a contract of loan, covering all transactions, with agreement to turn over the original funds as soon as received to the finance company, and in case of failure of the debtor to substitute other accounts, or assume the obligation, etc.

As soon as the papers are complete the finance company will advance 80 per cent of the amount, charging six per cent on the face of the invoice, plus the service

charge. Some concerns work on the "notification plan," whereby the debtor is notified of the assignment, in which case the payment is made direct to the finance company; but more often the loans are made on the non-notification plan, wherein the debtor deals with the borrower direct. In the latter case a bond of indemnity may be required, safeguarding the company against diversion of funds by the borrower.

Assuming that the shipment has gone forward on the first of the month, Wanamaker will not pay the bill until the last day of the discount period—the tenth—and his check will reach the furniture company on the eleventh, and go into its bank balance on the twelfth. Assuming the discount company to be situate in the same city as the furniture company, it will have payment for the goods within a day or two of their leaving the factory. It will therefore have ten days' advantage, even assuming Wanamaker takes his discount. Upon receiving Wanamaker's check, the furniture company sends it to the finance company and receives credit for it in full, and in return the company's check for the balance due on the transaction.

By this process the furniture company receives cash for its goods as fast as they go out. Granting that the cost of this form of finance is high, the fact that sales are practically on a cash basis offsets the additional cost of credit. With ready cash available as fast as goods are delivered, the borrower can buy for cash and take his discounts, thus reducing the average cost of his borrowings. Concerns which use this method consent that it is costly, but on the other hand show as a practical conclusion that it is profitable. It is essentially so to the discount company; but inasmuch as their loans are of inferior quality, and the risks are greater than banks are willing to assume, the return should be more substantial; for

this reason this line of credit requires experienced men to handle and watch the course of business lest the profits be turned into losses through the vicissitudes of business life. In the readjustment period of 1920–21, such lending companies suffered heavy losses in the failure of weak concerns that were not sufficiently fortified to withstand the shock of falling prices.

A few banks will lend on accounts receivable, but it requires a special department and special skill to handle successfully, and generally speaking such loans are not to be found as a part of banking procedure.

Organization of Credit Company.—A credit company is organized in the same manner as any other corporation. Funds are obtained through the issue of capital stock, usually preferred and common. The preferred may be of par value of any amount decided upon, and the common may likewise have a par value, but the better way is to have the preferred carry a fixed rate of dividend, cumulative, but without voting power. The common stock should have no par value, but should have voting power. The stock is usually sold in combination, one share of preferred carrying a certain amount of common. Assuming the preferred to be $20 par value, and the common no par value, the combination will be sold at $25. This allows the company to pay a selling commission out of the proceeds of the common, and it sets up as a liability only the amount actually received by it, a decided advantage in making up a statement. The laws of some states tax the common stock for its actual sale value, or at a fixed rate per share, although it has no par value; and the saving in taxes is considerable in the no par value plan. In considering this feature of organization, the law of the various states must be inquired into before coming to a decision.

The powers of the company are broad and include the purchase, sale, exchange, etc., of accounts receivable, commercial paper, bills of exchange, bills of lading, warehouse receipts, securities of all kinds, leases, choses in action, etc

They may also issue debenture bonds, trust receipts, etc., and may own real estate and personal property They may not, however, do a banking business. These debenture bonds or trust receipts are issued against collateral taken by the company for loans. The collateral is deposited with a bank or trust company which holds the same as security for the debentures or trust receipts. The amount of debentures is limited to about 75 per cent of the value of the collateral deposited. The amount of debentures permissible to be issued depends upon the collateral agreement with the depository or may be regulated by the charter. These debentures mature in periods of from three months to a year

The process in essence is as follows. The credit company loans against certain collateral up to about 80 per cent of its face value. This collateral is then deposited with the trustee and debentures up to about 80 per cent are issued against the collateral; so that the holders of the debentures are secured by a double margin of safety. The trustee guarantees nothing except the regularity of issue, and does not warrant the payment of the debentures. These debentures are sold to banks, insurance companies, firms, etc., in the market for short time paper, carrying a rate sightly in excess of that which obtains on commercial paper and banker's acceptances. The depository banks holding the company's cash balances will also make loans secured by assigned accounts and also on open credit.

Many of these companies are backed by banks which encourage this form of financing in order to provide

credit facilities which as a bank they are unable to furnish to their customers. In some cases the bank officials will be officers and directors of the company.

The trust receipts issued by the large and well-known finance companies have a broad and steady market among banks, and have a remarkably clean record. The security brings into play several factors, as follows: (*a*) The obligor on the account, or buyer, (*b*) the guaranty of the seller of the merchandise; (*c*) the margin; (*d*) the assets of the credit company. They are therefore secured from several angles and in the diversification of the risks and the pyramiding of guaranty, safety of the first class has resulted.

Having a steady outlet for its trust receipts, the company may continue to loan, inasmuch as it has what is essentially an unlimited rediscount market at its command. Up to the limit set by the charter or the trust agreement, it is an endless process.

Non-notification Plan.—In the non-notification plan, the credit company does not notify the debtor. The account is assigned without the latter's knowledge, and it follows that the borrower must be a good moral risk if he is to be allowed to collect the debt and turn the proceeds over to the credit company. The assignor guarantees the credit, and also warrants that the proceeds will be applied to the liquidation of the debt to the credit company. In some instances the credit company will not loan on an account under the non-notification plan, but will advance against it under the notification plan It is obvious that the moral risk must be of high order if the borrower is to be his own collector.

Many concerns hesitate to have it known by those with whom they deal that their credit is of such character as to make borrowing on accounts receivable a necessity.

In the textile trades the custom is so firmly established that no injury to credit results from this practice. Many firms have their invoices printed with notice of assignment of the account to the factor, as a fixed policy; but other concerns will not deal on the notification plan at all. On the other hand, some credit companies deal only on the notification plan. It is difficult to see how the assignment of an account receivable can injure the credit of the seller with the buyer. The buyer enters into a contract to purchase certain goods on agreed terms. He should not be concerned to whom he pays the bill, as long as the credit terms are complied with. The loss of credit may come about through knowledge of the banker that the customer is resorting to this practice, and it should be done only with the consent of the banker. Such a practice can injure the credit of the borrower if done under cover, but if he is honest with his banker it can greatly assist him

Contract with the Credit Company.—The agreement with the credit company on the part of a seller of accounts receivable is a broad one and rigid in its terms Among the provisions are. (*a*) The seller of the accounts agrees to allow the auditor of the credit company to inspect his books at their pleasure; (*b*) the seller agrees to pay the salary and expenses of the auditor unless there is an auditing charge, which covers the cost of audit, (*c*) the seller agrees to turn the original check over to the credit company on the day of receipt, (*d*) the credit company has power to transact any business relating to the assigned accounts, such as indorsing checks, etc., with the name of the assignor.[1] (In order to keep the buyers in ignorance of the fact that the seller deals with a credit company, the latter company is allowed by its depository banks to make indorsements by the

[1] Modern Credit Company, p 25

use of a number only. A contract is lodged with the bank which makes the stamping of a designated number equally as binding as a complete indorsement.)

Testing the Credit Risk.—Before the credit company will buy an account it makes the same credit investigation that a bank would make in a loan. Dun and Bradstreet are used very largely and the company makes credit inquiries among the trade and banks, and in time accumulates a credit file of its own covering its customers thoroughly Inasmuch as the risk assumed by the credit company is greater than obtains in bank and mercantile loans, the credit investigation must be the more exact, if the risk is to be correctly judged. It may be assumed that the banks have taken the least risk, leaving the greater for the credit company and it must use the more care if it is to be properly protected in its loans

Reasons for Selling Accounts.—Among the reasons for selling accounts receivable may be mentioned the following:

1. The firm may have a profitable and growing business and insufficient capital It can safely handle a larger volume of business with greater credit facilities The additional profit on an increased business will warrant the high cost of capital obtained through the credit companies.

2. The credit company's facilities make it essentially a silent partner in the enterprise; and the giving of a share of the profits to the company obviates the necessity of taking in new partners or increasing the capital. This process retains the original ownership and control.

3. The concern may have a heavy plant investment and need working capital.

4. Many concerns are better versed in manufacturing and selling than in financing and find in this a convenient method of obtaining credit, irrespective of the cost. In

obtaining their loans from a credit company they are under no obligation to carry large cash balances.

5. The line of credit obtainable in banks may not be sufficient to handle the business.

6. Many concerns need the facilities only during the busy season and the credit is but a temporary measure

7. By financing their sales through the credit company, the borrower may work on essentially a cash basis. The rapid turnover of goods for cash, allowing the benefit of cash discounts in purchases, offsets the high cost of money.

8. Concerns in financial difficulties often turn to the credit company as a last resort in the hope of pulling through. These are the most undesirable risks and it is for the credit man of the company to select these risks with the greatest of care.

Risks in Lending upon Accounts Receivable.—The risks assumed by the credit company are several, as follows (*a*) The account may be fictitious, old or disputed. The integrity of the borrower must cover this risk. (*b*) The assigned accounts may not be collected due to weakness on the part of the buyer This risk can only be minimized by careful credit investigation. (*c*) The proceeds may not be turned over to the credit company. To safeguard against this, the company frequently requires a surety bond guaranteeing the fidelity of the borrower.

Cost of Discounting Receivables.—The cost of discounting accounts receivable varies in the different companies In addition to the fixed rate of interest there is the service charge which as a rule is $5 per thousand dollars of business transacted. This is presumed to cover the expenses of audit and credit investigation. It is generally conceded that the cost to the borrower is about 18 per cent on the amount actually received by him. In some concerns it will run higher

than this rate. Assuming the borrower to make a gross profit of 40 per cent he is often willing to forego one-half of this profit in order to handle his business more expeditiously and in larger volume.

Financing Time Sales of Pianos, etc.—Articles sold on time payments running over a period of months, are financed as follows

The article is sold upon conditional bill of sale or upon chattel mortgage, the former predominating. The bill of sale retains title of the article in the seller until the last installment is paid. If the payments are defaulted those paid constitute rent for the use of the article, and repossession is a simple process of taking back the article. Legal action such as foreclosure is not necessary in a bill of sale, while it is a requirement under a chattel mortgage Recording the papers is not necessary under a bill of sale while a requirement under a chattel mortgage.

A part payment is required sufficient to give the buyer a substantial interest in the article, although at times this payment is small.

A serial note or a series of notes are taken, which may be indorsed or assigned to the credit company, and by them in turn assigned to a bank or trust company and debentures issued against them. Loans are made up to about 80 per cent of the face value of the assigned notes and debentures are issued up about the same limit, thus following the general plan in borrowing against accounts receivable.

It is stated upon good authority that 85 per cent of the furniture sold is on the installment plan. But 4 per cent is taken back by the sellers, and the losses on total sales are but 1½ per cent of sales This shows the safety of such credits and the necessity for credit companies to carry the risks.

Loans on Life Insurance Policies.—Life Insurance policies constitute most excellent collateral, provided they have a cash surrender value. Practically all policies now have a surrender or loan value after a certain period, two or three years as a rule. The companies guarantee to lend up to a certain stipulated amount, or to return a certain amount to the insured upon request, according to a table attached to or forming part of the policy. The bank may have what is essentially cash security by taking such policies as collateral to loans. The requisites are: (*a*) The beneficiary shall consent to the transaction; (*b*) the policy shall be assigned to the bank, and preferably on forms supplied by the company, (*c*) the assignment shall be recorded with the company and their acknowledgment returned; (*d*) the premiums shall be paid when due. The bank may therefore lend up to the cash surrender value of the policy in safety, but should be in position of having the papers in "good delivery"—which is to say in such form that the bank may collect the stipulated amount from the company in case of default. When the assignment is lodged with the company, and acknowledged, the premium notices will thereafter be mailed to the bank, which should see that they are paid and the receipts placed with the loan papers.

Loans on Savings Bank Books.—Another form of highly desirable collateral is savings bank pass books Where the savings banks pay interest at stated periods, such as January and July, the depositor as a rule forfeits interest on the amount if withdrawn prior to the interest dates. The penalty depends upon the custom of the bank in crediting interest. Thus, if the custom is to pay interest from quarter days—January, April, July and October—a deposit made early in October will draw interest for three months if left until

Jan 1. If withdrawn in December no interest will be allowed.

In many cases the depositor will need his money before the interest period is complete and will find it more profitable to borrow for a short time even at 6 per cent than to forfeit interest for a longer period at a lesser rate. He therefore pledges the pass book as security for a loan. Such security is essentially cash. The requisites to such a loan are: (*a*) The pass book is presumed to show the amount due the depositor. This should be verified before accepting the same as security. (*b*) The book should be assigned to the lender, either by assignment or by check properly drawn. (*c*) The savings bank should be notified of the assignment, and (*d*) the acknowledgment of the savings bank should be obtained and filed with the papers.

Automobile Financing.—With the development of the automobile there has come about various forms of financial operations peculiarly suited to the special requirements of the trade. The manufacturer in selling to the dealer takes no risks. He demands cash upon delivery of the car. The burden rests heavily upon the dealer, who is frequently a man of modest means, doing a business which runs into money fast, and must have the assistance of his bank in order to make deliveries. The problem has been to devise a method which would be safe for the bank and yet not burdensome or impossible to the dealer. The solution has been found in a proposition based upon honor.

When the car leaves the factory a draft is drawn covering the shipment. To this is attached a bill of lading the possession of which is necessary in order to obtain the car. A duplicate of the invoice is also attached. The draft is usually payable at sight, but with instructions to hold until the arrival of the goods. This saves the documen-

tary stamps which are not required on demand bills. As soon as the bank receives the draft it notifies the dealer. When the shipment arrives the railroad company also notifies him, and the loan machinery begins to work.

In making such loans two things should be kept in mind (*a*) The type of car; (*b*) the type of dealer. Experienced bankers have come to the conclusion that both are essential to satisfactory results. The number of automobiles is legion. It is obvious that all cannot be the "best sellers." A banker who has had an unusual experience in this line states that he would not loan on any car that did not have a broad and steady market and particularly a good second-hand market In his list there are not over six makes. He eliminates practically all the special mode's, "sport cars," new creations and new names from his list, on the theory that they do not sell themselves, as do the more popular types, but have to be sold Their field is limited and their durability not yet demonstrated. He sticks to the cars which have grown up with the industry and stood the test of time. He is cautious about the more expensive types, on account of their limited market.

Treating the automobile as a commodity, we require ample margin for safety's sake and to cover any change in price. Cars are sold f.o.b. factory The war tax is added to the invoice and likewise the freight. The dealer is allowed a certain commission, usually under 20 per cent on the factory price. He must advance the war tax, freight and the margin, before he can obtain the car. Therefore 20 per cent of the facto y price plus the tax and freight will give him a substantial investment in the car. On some types of car, it is safe to advance 80 per cent of the net cost to the dealer. On others it would involve a certain amount of risk. On the humble

Ford with its steady market and quick turnover 80 per cent of the cost price to the dealer is amply safe.

The dealer signs a collateral note for each car, describing it by name, model and motor or car number. A trust receipt is made out in duplicate, with similar description The trust receipt acknowledges that the car has been purchased with money advanced by the bank and that the title is in the bank. In it the dealer agrees not to use the car for demonstration (which quickly puts it in the used car class) and to keep it fully insured against fire and theft, and he agrees not to sell except upon release of the bank. The release is at the bottom of the trust receipt with perforations for tearing off

As soon as he executes the note and trust agreement, the loan is credited to his account and his check may be drawn for the face of the draft. When the car is sold the loan is paid, with interest and stamps, the release is executed and the records marked off. If the dealer accepts notes in payment, the bank may accept these in lieu of cash, if so desired. This makes two-name paper

The automobile industry is very largely dependent upon bank credit in order to carry on its operations. While this is true in all lines of business, it is especially so in the automotive industry. Bank credit is applied to auto financing in a great many ways, and private credit in the form of book accounts is not the predominant form. Sight draft with bill of lading as against term selling distinguishes this from other forms of business. The retail selling is, like the wholesale buying, on a cash basis. There are few dealers who are strong enough in their capital holdings to carry their customers. The individual sale runs into larger figures than is common in other lines and the individual credit is therefore larger. The bank enters this form of business in four distinct ways:

1. It finances the dealer in his purchases from the wholesaler.

2 It finances the purchaser of the car, directly or indirectly.

3. It finances the security company that finances the dealer and the purchaser.

4. It acts as trustee for the collateral trust notes, through which the finance companies, owned or controlled by the automobile companies, finance the dealers and purchasers.

In financing the dealer on the trust receipt plan, the element of character stands out prominently. While the car itself, with proper margin for safety, is the security, it is no security at all in the hands of one without business character. In other forms of collateral, the goods are under the control of the banker, physically, but as a rule in auto financing the cars are wholly under the control of the borrower, which is not according to accepted loaning principles. The dealer is given every opportunity to play false with the banker, among the risks being:

1. The use of cars on trust receipt for demonstration purposes, thus quickly impairing their value.

2. The delivery of cars without proper release.

3. The substitution of cars, so that while the number of machines may be on hand, their numbers will not coincide with the bank's records and therefore be of no value as collateral.

4. The car may be pledged in two or more places.

It is obvious from the above summation of risks that unless the dealer is a man of strict integrity the bank is assuming undue risks. And unless the bank feels certain of its moral risk, no risk should be assumed at all.

With the growth of the automobile industry has come the finance company for the purpose of handling the time

paper which arises out of car sales. These companies specialize in automobile paper and do a large volume of business. The buyer must pay from one-quarter to one-third the purchase price in cash. To the balance is added the insurance premium covering the various risks such as fire, theft and accident, the interest on the amount until maturity and a service fee. The total is divided into as many parts as there are payments to be made. The term is usually ten months. The buyer executes a series of notes which the discount company will purchase, giving the dealer the net proceeds. In some cases the dealer indorses the paper and in others he is out of the transaction altogether. With the proceeds of notes discounted at the finance company and the cash payment, the dealer pays the bank for the advances on trust receipt and, so far as he is concerned, the transaction is closed. Another essential element in automobile loans is the methods of the dealer. He must be able to keep correct records and be thoroughly reliable. The bank must feel confident that no car will be sold without a release, that none will be uséd for demonstrating and that the transaction will be exactly what it is intended to be. If the trust agreement is broken to the point of absolute sale without reimbursement, it will amount to fraud, and the bank may follow and reclaim the car wherever it may be found. The buyer does not get good title until the bank has executed its release.

Banks handling such lines of credit should frequently check up the cars in the dealers' hands with its records, by motor or car number It will sometimes be found that the dealer has the number of cars called for, but with different car and motor numbers. In his bookkeeping he has gotten his numbers confused. It will sometimes happen that cars have been sold a day or two prior to the checking and the process of payment is

under way. This is not a serious matter, inasmuch as the transaction often takes a few days to complete. It may be found that the dealer has used a certain car as demonstrator until it is in the used car class. There will be types of cars that move slowly and a loan will become stale while the car is on the floor. In such cases new cars should be substituted for the old ones. If the dealer is known to be borrowing on cars in other banks, the banks should check up with one another frequently in order to determine if the same car is pledged twice.

Used Cars.—It has well been said that in automobile salesmanship, two sales must ordinarily be made to effect one. Since the users of cars became numerous, a great many if not the majority of sales are "trade-ins." The dealer makes an allowance for the old car, and the competition between dealers and makes of cars frequently resolves itself into a bidding against each other in the allowance on the old car. The retail profit on cars does not exceed twenty per cent as a rule, and the prices are fixed by the maker. The dealer cannot make concessions from the listed price He may, on an original sale, include in the price a spare tire, extra equipment, etc., but this is unethical and constitutes a cutting of factory prices, which is probibited. It is a common practice nevertheless. But where there is a used car involved, the dealer must make an allowance, basing his figures upon the sale value of the trade-in car. If he makes too large an allowance he will sacrifice part of his profits on the new car, and the real art of automobile salesmanship as now constituted consists in gauging accurately the second-hand market. An illustration will show the wide divergence between dealers in this respect: In seeking to buy a new sedan, the choice lay between a Dodge, a Willys-Knight and an Essex.

The buyer had an Overland sedan as a trade-in. The Dodge dealer offered $250 on a new car selling at $1,550, the Willys-Knight dealer offered $350 on a car selling at $1,750; while the Essex dealer offered $400 on a $1,250 car. In such cases the dealer has to consider how much repairs are necessary in order to make the old car salable and how much he can get for it when reconditioned. If no repairs are necessary or warranted, he must judge the market for the car "as is."

It follows that in reading an automobile statement due allowance must be made for the item of inventory as made up of used cars. Some dealers are remarkably conservative and fortunate in their trade-ins, while others are quite the reverse. A new dealer and inexperienced will make large allowances in order to effect sales and shortly find himself with his capital invested in a line of old cars that cannot be moved except at ruinous prices. In many places public auctions are held for the purpose of getting rid of the old cars. A drastic cutting in the item "used cars" is not only advisable but necessary, if the lender is to be safe in his credit conclusions.

Banks as a rule do not favor the time payment notes taken in automobile sales, preferring to have these credits carried by concerns especially fitted to handle this business. Not that these credits are not safe, for only a small percentage become troublesome, but the risk must be more carefully examined and by a different process than obtains in bank loans generally, and the bookkeeping methods are peculiar to this form of credit. The time payments must have a well organized follow-up system, the insurance must be kept in force, proper security taken to protect the company and each loan given individual supervision that cannot be done in banking practice. It is found that any selling plan

that is based upon time payments must have a finance company as a necessary adjunct, and practically all such industries have discount companies which handle their respective credits. These companies have standard schedules of time payments, based upon the number of months the credit runs and the amount paid down at time of sale.

From a long experience in handling automobile loans, the author is in position to state that automobile financing can be made sound and profitable. Out of hundreds of cars handled in the course of five years only one transaction developed trouble of a serious nature. Constant care, frequent checking, careful selection of dealers and types of cars, and a knowledge of the automobile business as respects price movements are essential to success in handling this form of credit; but it has no more dangers than other forms of credit, and has many points of merit not found in other lines of business.

Loans on Real Estate.—Loans with real estate as security, commonly called "mortgage loans," are made by banks in general, and in savings banks circles quite exclusive of all other classes of loans. State banks and trust companies as a rule have the right to make such loans, and generally do so. Prior to the Federal Reserve Act, national banks could not legally make mortgage loans, but in many instances real estate was taken as security under the form of collateral loans At the present time all national banks except those in central reserve cities have the right to make such loans. (For restrictions see under national banks.) Whether the loan is made by a banking institution or an individual or other corporation, the process is the same.

1. *The Application.*—Application for such loans is usually made upon an application blank furnished for the purpose and gives the following information: Name of

borrower, location of the premises, size of same, character of buildings and description thereof, amount applied for, assessed value, rental income and in some cases owner's valuation. The approval of the appraisers is generally taken on the application.

2. *Appraisal.*—The property is inspected by an appraisal committee or other competent appraisers, who visit the property and place their value upon the land and buildings separately. The amount to be loaned is fixed by the appraisers.

The maximum amount that may be loaned is regulated by law. In state banks and trust companies this is fixed by the state laws and in national banks by the Federal Reserve Act. As a general rule this amount does not exceed 60 per cent of the appraised value. In national banks it is limited to 50 per cent of the appraised value

Real Estate Values.—The valuation of real estate is a subject in itself and worthy of the study of all who conduct banking institutions. In the large cities it is a fine science, with many factors to consider. In the smaller places it is not so difficult a problem, the influences that affect values being less complicated than in cities The factors usually considered in placing a value upon real estate are:

As to land: Sales previously made.
Location—street, location in block, etc
Surroundings.
Desirability for business or residential purposes.

As to buildings: Cost to construct.
Cost to replace
Rental income.
Adaptability
Utility.
Convertibility.

The two most reliable factors in regard to buildings are the cost to construct and the rental income. Looked upon in the light of an investment, property must show an income of at least 6 per cent net. This is called "capitalizing the rents" From the rental values must be taken taxes, interest upon mortgage, insurance, water rents, repairs, etc.

As a general proposition property must show at least 10 per cent gross income in order to be a fair investment. Some properties show much more income than this, but these are the exception and not the rule. In the large cities the owners of office buildings are satisfied with a net income of 5 per cent, and some of the most expensive buildings in New York do not in normal times show more than 3 per cent net.

The cost to construct must be considered in the light of construction prices. During the period following the war the cost of building was approximately 100 per cent higher than in 1913, and building operations were so greatly at the mercy of labor unions and material manufacturers that the costs were unduly high. Mortgage lenders in appraising property under such conditions well knew that the inflated market could not be permanent, and while considering the current costs, reduced the margin of loans to about 40 per cent of the appraised value or the cost, in order to be safe in a falling market which was inevitable.

The cost of building has been so scientifically worked out that it is possible to estimate with a considerable degree of accuracy the probable cost of any type of building. From past experiences the cost of different types is known and by computing the cubic feet in the building, the cost may be estimated.

In a stable market this is an excellent guide; but in a spasmodic and erratic building market, such costs vary

from month to month, and are safe only when considered in the light of current events. There are savings bank officials, appraisers and other mortgage lenders in New York who can correctly appraise the cost of any type of building, from the modest frame cottage to the elaborate apartment house, if the cubic contents is known to them. Upon these probable building costs, building loans are made to be consummated as the building progresses. Such loans are progressive mortgage loans, becoming permanent loans upon the completion of the structure. The usual term for mortgage loans is three years, although the policy among savings banks is to allow the loan to run as long as the mortgage is fully protected by the quality of the property.

Upon favorable action by the appraisers, the loan machinery begins to move.

3. *The Title.*—Under the legal rule that a man cannot convey what he does not own, the title of the owner must be absolute, otherwise he cannot make a valid mortgage This part of the loan process devolves upon the attorney for the bank. He will make a "search" of the property. This means that the chain of title will be examined in the hall of records. Frequently this goes back fifty years, and a history of the ownership is taken from the records as found in the public offices. When the attorney is satisfied that the title is clear (except as stated) and vested in the mortgagor, a certificate of title is executed which certifies that the title is good and is so vested. Of late years it has become common for title companies to make these searches and to certify to the title. The instrument is called a "title policy" and not only certifies to the title but guarantees to make good any defect and to defend any action that might bring the title into litigation. Title policies are preferred to certificates of title, the one being a guaranty, the other merely an opinion.

4. *The Loan Papers, Bond and Mortgage.*—All mortgage loans are accompanied by. (*a*) The bond. This is the obligation, under seal, and which in essence is a dignified promissory note. It is a formal acknowledgment of the debt. In it the borrower promises to pay the principal at a stated time (usually from one to three years from date) and the interest at stated times, at a stated rate Payments of interest and principal as made should be indorsed on the bond and signed by an officer of the bank. (*b*) The mortgage. This is essentially a conditional deed. In it the mortgagor conveys the property to the lender (the mortgagee) provisional upon failing to pay the amount named in the bond with interest. The property is described in detail for identification purposes and the conveyance clauses are similar to those used in deeds. In executing these two papers, which are always dated on the same day, and usually in the same amounts, the borrower promises to pay the amount borrowed and pledges the property as security. Such loans are spoken of as "loans on bond and mortgage"

5. *Recording the Papers.*—After execution, the mortgage is filed in the hall of records (or county clerk's office) where they are copied on the record books exactly and in full as they are drawn.

The mortgage only is recorded, and is so stamped and signed by the recording officer, with the exact time of recording *Mortgages become first, second and third, etc, according to their time of record.*

6. After signing the papers the borrower is paid the money, usually by check as evidence of payment. The bond is filed with the loan papers and the mortgage likewise when it is received back from the hall of records, which is usually weeks and even months after the filing.

7. *Insurance.*—The property must be protected from fire and the lender must be safeguarded in case of fire.

Therefore the insurance is made to run to the bank or lender by a "mortgagee clause" which makes the amount payable to the mortgagee "as its interest may appear." In the event of fire, the insurance check will be drawn to both the mortgagor and mortgagee, thus requiring both signatures before the insurance money can be collected This protects the lender from having the buildings burn, leaving only the land as his security. It may be opportune to state here that only the land is mortgaged in such loans; but a lien upon the land carries with it a lien upon all buildings thereon, and a mortgage loan covers all buildings within the scope of the described mortgaged premises. It frequently happens that buildings are innocently erected upon another's land, through mistakes in locating the exact lines of the plot. But even though the wall encroaches but an inch upon another's land, it will be covered by any mortgage placed upon the property to the extent of an inch. Any buildings erected upon a plot already covered by a mortgage will automatically be covered by the existing lien For this reason it is the rule to require

7. *A survey* of the premises made by a competent surveyor, showing the exact lines of the plot and the location of the buildings, to a fraction of an inch, especially in abutting property. On home property, with land on all sides, this is not so important a factor, but should be required where the buildings are close to any line. In other words, the buildings must be within the mortgaged land.

8. *Taxes.*—Inasmuch as taxes are a first lien upon land, and come ahead of all other liens, it is important that the taxes assessed against the property be paid. This is evidenced by a "tax search," made in the tax office and similar to the land title search, but running back only so far as is necessary to protect the property from future tax sales.

After the loan papers are complete and the loan closed, interest is collected as due, the mortgage collected or extended when the time has expired and the insurance kept in force. This is done by:

9. *Insurance Expiration Register.*—This classifies all policies held by the bank according to due dates. The information is: Owner, amount of policy, company, number of policy, broker, date of expiration. As fast as policies lapse they are replaced by new ones or renewals If the owner does not furnish a new policy to take the place of the old when due, the bank will have a policy written by its own broker and charge the premium against the owner and collect.

The payment of taxes should be followed up by requiring the owner to produce at least yearly his tax receipts and due notation should be made of the payment of taxes Some banks have a tax search made every year or two to cover this point, while others watch the public notices of impending tax sales and examine the same for tax sales that affect premises mortgaged to them.

Rediscounts.—Rediscounting has not been a common practice among American banks. Most of a bank's paper is payable at its own counter and is local in character. If it were rediscounted it would have to be indorsed by the holding bank thus giving notice to the maker of the note that it had been sold to another bank. To overcome this objection some banks have issued a blanket guarantee on all notes discounted, or have registered a number under proper resolution of the board, which number placed upon the back of negotiable paper is equivalent to an indorsement. All notations made in such a transaction are made upon an attached slip in order to keep the paper itself free from any marks that would indicate that it had passed out of the possession of the discounting bank.

Where correspondent banks find it necessary to borrow, the usual form has been in the form of a loan against securities, particularly since the Liberty loans placed large amounts of these securities in all banks. The rates are usually less on government securities than on rediscounts, and a great many banks keep Liberty Bonds with their correspondents constantly in order to borrow quickly in case of need. Moreover such loans do not require documentary stamps.

Rediscounts with the Federal Reserve Bank.—Rediscounts are in favor with the Federal reserve banks and are freely made to members who offer eligible paper. The proof of the eligibility must be satisfactory to the Federal officials and offerings are made on forms furnished for the purpose. Where such a process obtains, one form of asset has gone out of the bank's control and another in the form of cash or balance due from Federal reserve bank has taken its place. The paper may still be held as the property of the bank and a liability in the form of "rediscounts with Federal reserve bank" set up to balance the transaction. If the notes were sold to another bank without obligation on the part of the selling bank, no liability would arise; but such is not the custom. However, the liability is largely contingent upon the maker's failure to meet the paper.

CHAPTER XXI

COMMERCIAL PAPER

The term "commercial paper" or "bought paper" is used to designate promissory notes issued by large concerns in *even* and *uniform amounts* and sold through commercial paper brokers. The denominations are, as a general rule, $2,500 and $5,000, and the form in no wise differs from the ordinary promissory note as used in business and banking circles. These notes are usually the single obligation of the issuing concern, although in some instances the paper is indorsed, but more often it is guaranteed by the individual members of the firm or by some affiliated interest. Guarantees and indorsements are the exception and not the rule.

This form of financing is peculiar to American business, and is not found in other countries. It is directly traceable to the book account form of credit, also quite distinctive as an American custom. Book account credit is in turn traceable to the depreciated Greenback as treated under that head in its appropriate place [1]

From a somewhat obscure and humble beginning the commercial paper idea has grown to large proportions, and while the number of brokers acting in this capacity is now extremely limited, the volume of business done by them runs into the millions weekly. There are scarcely a dozen nationally known houses in New York at the present time, but the business of the larger ones will run from two to three millions a week

[1] See Chap III.

Origin of Commercial Paper.—During the period immediately following the Civil War, it was the custom of merchants to visit the trading centers and buy their stocks for months in advance, making but few buying trips a year. In payment they gave the wholesalers and jobbers their promissory notes, payable several months after date, and at a time when the goods, in the course of business, would have been turned into money

When the time for payment arrived the debtor would pay the amount in Greenbacks, which were at the time at a heavy discount. The instability of the currency made future contracts difficult to consummate in fairness to the creditor, and in such instances he would naturally cover himself insofar as possible in the price of the goods. In order to induce the buyer to make prompt payment of the invoices in cash, a custom arose of offering a concession from the face of the invoice if the amount were paid within a stated time. The discount for payment grew less as the time was extended, the shorter period carrying the heaviest concession.

This innovation made it necessary for the seller to carry the buyer on his books until payment was received, and the *form* of credit became a charge against the buyer on the seller's books instead of a promissory note Owing to the form of the credit, the seller could not use it as a bank instrument and had to find another method of securing funds to carry his customers during the period of the credit. He had two avenues open (*a*) His home banks, which as a rule were not large enough to legally extend to him the amounts necessary to carry on his business, and (*b*) the open market as represented by banks throughout the country. It became necessary to have an intermediary to make the offerings to the banks, and the commercial paper broker came in to act in this capacity.

As the means of communication developed, the buyer no longer approached the seller, but rather the seller approached the buyer through traveling salesmen The buyers therefore made more frequent purchases in smaller lots, and did not need a long time credit period in which to turn merchandise into money. The visits to the trading centers no longer became necessary except in seasonal and fashionable lines where style is the chief consideration.

The selling on book credit may be said to be essentially the consigning of goods selected from sample, with the right to return undesirable merchandise and that which does not come up to the agreed quality.

The Cash Discount System.—The cash discount system is now as thoroughly a part of American merchandising methods as the book account, and is characteristic of all lines of business. Even the smaller firms allow such concessions upon the smallest orders. So universal has this custom become that all well-managed concerns endeavor to take their cash discounts, considering them not only a source of profit but a badge of honor. Where the period of discount is anticipated, interest is allowed for the unexpired time by which the discount period is anticipated.

The terms of discount vary in the different lines of merchandising, but are generally uniform among the merchants handling the same line of goods. In making up statements of accounts receivable, deductions are allowed for the probable percentage of debtors who will take their discounts.

In order to sell on "terms" as above suggested, the seller must be in position to charge the buyer with the amount upon his books, which constitutes an *account receivable,* and carry the credit until it is liquidated. The seller, in turn, wishes to take his cash discounts and

resorts to commercial paper borrowings in order to do so. The retailer taking his discounts finds it profitable to borrow from his bank in order to take his cash concessions and as a general proposition it is advantageous to do so. The credit period extended by the wholesaler is therefore shortened to his cash discount periods, and in substance places American business on what is essentially a cash basis.

Advantages of Commercial Paper to the Borrower.—Inasmuch as a large number of business concerns, and some of the largest and best in the country, have resorted to open market borrowing in the form of commercial paper, it follows that there must be distinct advantages to them as well as to the banks in this form of finance These advantages briefly stated are:

1. The open market rate is usually lower than prevails in the home banks. The borrower has the advantage of borrowing in the broad market, in the large city banks as well as the country banks, and is able to take advantage of the general money market as distinguished from the restricted field of home borrowing. Only under exceptional conditions, such as prevailed during the war, will the market rate rise above the home rate During this period the market rate rose as high as 8 per cent, while many local banks were asking but 6 per cent, but this condition did not long continue.

2. The home lines may be kept open for emergencies.

3. A larger line of credit may be obtained than is usually the case when dealing with a few local banks of limited resources and limited loaning ability. But few banks could or would loan a single concern as high as a million dollars, but the open market will easily absorb such amounts if issued by substantial and well-established concerns

4. A firm which issues paper frequently, protects it properly, pays promptly and cleans up periodically, establishes a reputation among banks that plays an important part in subsequent financing where bonds or stocks are issued. Many such firms find it advisable to put out long time bond issues, or capitalize their business with a larger stock issue, and having become favorably known as a commercial paper risk are in good favor among the banks. Many cases illustrating this principle could be mentioned. One will suffice. A leading manufacturer of ladies hosiery was for a long time a borrower on commercial paper. His name was well and favorably known as "prime paper" among hundreds of banks. In order to expand his business he decided to issue a large amount of preferred stock, amply secured as to assets and earning power. The mere mention of the name was sufficient to convey the impression that this offering was not only warranted, but safe as an investment. The banker knew his man. The issue of over two millions was quickly subscribed.

Advantages of Commercial Paper to the Banks.—The banks are likewise favored in having commercial paper as an outlet for funds, as follows:

1. Idle funds may constantly be employed at profitable rates.

2. Maturities may be coexistent with need for funds.

3. Rates may be higher than in local circles.

4. Payment is certain at maturity. Renewals are seldom asked for or granted.

5. Such loans have passed the test of credit men in banks and broker's offices, and an offering over the name of certain brokers is sufficient to stamp an offering as prime. The conservative broker is more careful than a bank could possibly be, inasmuch as there are no reciprocal favors to be considered. Quality is the

paramount consideration. The bank must consider what it gets from a customer as well as what it gives In buying paper the personal element does not enter

Banks buying paper need not renew the paper at maturity, but can depend upon the paper being paid, and may treat such loans as a perfect secondary reserve and essentially cash in sight The principal will not shrink. It is said upon good authority that no paper buying bank failed during the panic of 1907. Such banks had a steady inflow of funds which they could use for local needs Their paper holdings greatly strengthened their cash position at a time when cash was the essential element in bank operations.

Commercial paper constitutes an ideal method by which a bank may employ short time deposits profitably While the rates for prime paper are lower than obtains in the case of other investments, the banker may select his maturities with a view to his anticipated needs, and be reasonably certain that funds will be in hand at the appointed time. In an experience covering ten years in commercial paper buying, running into millions, the writer has had but one note that was not paid upon presentation. Some banks carry large amounts constantly, regarding this as a superior secondary reserve to bond purchases; for while profits may not be made by an increase in the value of paper, losses are seldom taken It is the investment par excellent of the banking world It has stood the acid test of years and has the cleanest record of all the forms of bank investment. Moreover, under the Federal Reserve System, it may immediately be turned into money, by the rediscount process, making it not only a secondary reserve, but essentially cash itself.

The Broker.—The commercial paper house has come into prominence as the use of this form of financing has become common It acts in a dual capacity: (*a*) As

the medium through which the borrower on commercial paper finds his market; and (*b*) as the medium through which the banks may make short time loans. The broker selects his risks with a care equal to if not greater than that used by the banker in making loans.

The broker is a specialist. He knows one thing thoroughly. All such houses maintain finely organized credit departments that keep accurate and exhaustive information regarding all names submitted by them The borrower seeking this kind of credit in the open market selects his broker (or vice versa). The first requirement is generally an audited statement made by an auditor acceptable to the broker. The broker is extremely careful that the figures to be submitted to his clients shall be as accurate and as trustworthy as humanly can be. He has a certain standard of audit which he insists shall be followed. He will make careful inquiry into the past history of the firm and the present standing of its personnel. He satisfies himself that the three big C's of credit are in evidence. His investigation will cover banks, business houses, personal acquaintances and business associates. Some brokers will not accept small concerns, holding that they are not large enough to warrant offering their paper in the open market

The broker informs himself concerning every detail of the borrower's business and often knows as much about the business as the executive heads. The broker seldom guarantees the paper. He never indorses it. The only guaranty that accompanies the paper is an unwritten one that the paper is regular, properly signed by those having power to bind the company, and that it is exactly what it purports to be.

Having accepted the name, the notes are made out, signed and delivered to the broker. As a rule the broker now buys the paper outright, deducting his selling com-

mission, which is one-fourth of 1 per cent and the discount at the agreed rate.

A transcript of the statement is then prepared and sent out to banks, while the field is covered by salesmen who also have a brief resumé of the main facts set forth in the statement. Assuming that such an offering is made to the reader, who is a bank official, we will go through the exact process of buying and checking the paper.

1. The salesman calls and we are "in the market."
2. He submits slips showing:
   (*a*) Name of maker
   (*b*) Maturity
   (*c*) Quick assets in total
   (*d*) Quick liabilities
   (*e*) Line of business
   (*f*) Rate (this varies with the quality of the names).
3. We select five notes of $5,000 each and place our order.
4. The paper will be received with a statement of the amount, less the discount at the agreed rate, on each name. Complete transcripts of the statements accompany.
5. We accept the same "on option"—meaning with the right to return the paper within ten days if it does not check to our satisfaction.
6. Draft is drawn for the amount.
7. Checking letters are sent to the banks given as references.
8. The statements are then analyzed after the manner hereinafter set forth, giving particular attention to:
   (*a*) The date, which must be recent, not over a year old, and preferably shorter.
   (*b*) The auditor.
   (*c*) The ratio of quick assets to quick liabilities.

(*d*) Character of business.

(*e*) Sales and profits.

9. The checking letters are answered and are satisfactory, our analysis is completed and the paper is finally accepted and the option is closed.

10. Ten days before the paper matures it is sent forward for payment to the correspondent bank, presented at the place of payment, and a day or two after its maturity a credit advice is received, the amount credited out of loans and discounts and the transaction is closed.

After buying paper for a time, certain names become known to the banker, so that he is familiar with the offerings and can select his paper from past experience. He knows the names of his commercial paper borrowers as intimately as he knows his local customers He makes comparative statements from time to time and eventually has a running record of the affairs of the names which he favors

Security for Commerical Paper.—The security for commercial paper is the *general worth* of the borrowing concern. The basis of the credit is a going business, able to meet its obligations, using the funds for constructive and legitimate purposes, and which has stood the test of the broker's exhaustive investigations, together with the same process as applied by the banks handling the borrower's cash balances.

Commercial paper is presumably issued for the purpose of buying raw material and carrying the manufacturing processes to a conclusion, or for the purpose of buying goods, taking discounts and carrying the customer during the credit period. In this respect it meets the requirements of the Federal Reserve Board that eligible paper shall be such as the proceeds of which have been used in one or more of the various processes from production to consumption.

CHAPTER XXII

ANALYSIS OF CREDIT STATEMENTS

The statement of a credit seeker is a summation of his assets and liabilities as of a given date. It should be a truthful and complete summary of his condition. It is best made by an independent auditor and one qualified by experience and training to make such an audit efficiently. It should not only be a transcript of the books, but be independently verified insofar as possible; for the books may be inaccurately kept, or fraudulently manipulated to make a good showing. Many of the items may be appraised from outside sources and this process should obtain.

Accompanying the statement should be a profit and loss statement showing the results of operation for the period, sales, gross and net income. There should be if possible a comparative summary running over at least five years and many statements are so set up.

Many concerns have a period when their indebtedness is at a low ebb and another when it is at its high. Such are seasonal businesses which clean up and go out of debt at certain times during the year. These concerns are apt to make their statements at such times in order to make a favorable showing as respects their debts. It is well to know if such be the case, in order that a comparison may be made with the figures at the heighth of the borrowing season, which will show the condition of the borrower at his worst. Human nature is prone to "window dress for an occasion" and show only the favorable side of its nature.

Classification of Assets and Liabilities.—A uniform arrangement in making up statements is greatly to be desired and this is gradually coming to pass as standard forms are adopted and used by banks through membership in bankers' and credit men's associations. The American Bankers' Association, together with various state bankers' associations, have adopted uniform credit statements which are commendable. Of prime importance is the classification of quick assets and quick liabilities, which are usually listed first. Following will be the fixed assets and fixed liabilities, as treated subsequently.

As generally stated the quick assets consist of:

1. Cash on hand and in banks.
2. Accounts receivable.
3. Merchandise, raw, finished and in process.
4. Notes and acceptances receivable.

Quick liabilities are:

1 Accounts payable.
2. Notes payable:
    (*a*) To banks
    (*b*) To merchandise creditors.
3 Wages.

Ratio of Quick Assets to Quick Liabilities.—As a preliminary observation, the credit man gives thought to the *ratio of quick assets to quick liabilities*. It is evident that the current obligations of a business must be met from current receipts, and the inflow of funds should be sufficient to meet the demands of creditors without strain. There must be a margin of safety to absorb any untoward happening in connection with the business.

In analyzing any credit statement, the liquidating possibilities must be considered. In other words, the borrower is presumed to be under necessity of closing up

his affairs, and the position of the creditors must be safe. As in making a mortgage loan on a piece of property, the lender consciously or unconsciously considers what the property would bring at a forced sale, so in passing upon a statement, we must consider what the assets would realize if sale were a forced process. Shrinkage there will be, necessarily, and therefore a margin is required as insurance against loss.

This ratio is generally fixed at a minimum of 2 to 1; two dollars of quick assets to one dollar of quick liabilities. Therefore unless the assets fail to realize fifty cents on the dollar, the creditors are safe. In some lines of quick liquidation and short credit, a lower ratio might be safe; while in others a larger margin would be required.

There are many factors to consider in arriving at a safe ratio, among which are:

History and personnel of the business.

Quality of the accounts receivable.

Quality of merchandise and its manner of appraisal.

Character of the business.

It is readily to be seen that an old established business will be in competent hands and likely to continue to be well managed; while a new business might be in inexperienced and incompetent hands, with the attendant dangers.

All accounts receivable shrink in collection, and unless proper reserves are carried this item will not realize par. The merchandise may be of such character and appraised at such a figure that it is a menace to the statement. The *basis* of inventory therefore comes into play as hereinafter stated. The class of goods has much to do with the liquidating possibilities. For instance, a stock of meats, butter, eggs, canned goods, etc., may be quickly sold at any time—at a price—while a stock of highly

seasonable goods that are fast going out of style will move slowly, if at all, and then only at ruinous prices. Such merchants must constantly feel the public pulse and force their wares on the market before losses are substantial. The acceptable ratio in respect to these two items is a matter of opinion and credit men are not agreed upon this point, but 1½ to 1 may be taken as the *minimum* for *any* business.

All well managed concerns aim to keep their quick assets and quick liabilities at an established ratio. In many security issues it is provided that the net quick assets to quick liabilities shall always be maintained at an agreed ratio while the securities are outstanding and any breach of this provision makes the whole issue callable

To this end experienced merchants buy conservatively and endeavor to have a quick turnover of stock by proper sales methods and careful selection of stock. A good credit department not only selects credit risks wisely but collects promptly, so that maturing bills may be met from maturing receipts.

It is obvious that if the ratio of quick assets to quick liabilities is more than 1 to 1, the owners of the business have an investment of the difference, in addition to their fixed assets; but if there be no excess, the creditors have furnished part of the working capital in the form of merchandise, and their ultimate safety depends upon the success of the management, otherwise they will have to fall back upon the fixed assets, which makes for an unsound condition.

Credit men, both in banks and mercantile houses, are giving proper attention to the ratio, as the first consideration for safety of loans and merchandise credits But in so doing it must always be with the quality of the assets in mind.

In an analysis of firms using the open market for borrowing and experiencing difficulties during 1921 and 1922, made by the National Credit Office, it was found that the average ratio of twelve firms having trouble in 1922 was 1.68 to 1; while for forty-eight concerns having trouble in 1921, the ratio was 1.71 to 1. This would seem to indicate that a ratio below the standard of 2 to 1 is unsafe except in a relatively few cases.

Cash.—In verifying the item of cash, the auditor has exact figures at his command, since this should be nothing but cash on hand and bank balances. Very few concerns find it necessary to carry a large amount of cash on hand. In the wholesale trades only petty cash is so carried, all other transactions being carried on by means of bank checks. In retailing, however, where sales are made over the counter for cash, there will be a necessity for till money in making change. This would be a reasonably large sum in a department store

The amount of cash necessary to carry on a business depends altogether upon the character of the business. A business having a constant daily flow of funds from sales will not need so heavy a balance as one where sales are seasonal or spasmodic. The bank balances should be large enough to meet the payrolls with ease and to carry on the current payments without undue strain. Too large a cash balance indicates idle funds which should be temporarily invested if not needed in the business. In the statement of a large concern, the bank balance was dangerously small—too small to be of any material benefit. Upon inquiry it was found that the firm had paid all its accounts payable just before the statement was taken in order to make a good showing upon the liability side; but it would have made a stronger statement to have shown normal liabilities and normal cash balances.

Upon first thought it would appear that this item needed no explanation or elaboration other than the usual verification statement. However, it is important to know whether any cash is in the form of time certificates of deposit and therefore not available for immediate use, and also whether the certificates are pledged and for what reason. Cash may be represented by cash items which are not collectible, and if so, the fact should be brought out in the report.

If an unusual amount of cash on hand and in bank is shown, the auditor should ascertain whether the excess amount is likely to be disbursed in dividends following the audit, and, if so, this fact should be reported.

Accounts Receivable.—Accounts receivable are the result of sales made and consequently carry with them the cost of the goods plus a profit. A high percentage of these will obviously increase the ratio of quick assets to quick liabilities inasmuch as a dollar invested in merchandise and turned into an account receivable carries with it the expected profit, while merchandise carries only the original investment, assuming the merchandise to have been valued at cost; and if the cost was greater than the market, this item will be stated at a loss that must be covered by future profits or absorbed in the expected profit in the accounts receivable. A proper line of good accounts receivable, of short maturity, is one of the firm's best and most liquid assets.

Accounts receivable are usually stated at their face or book value with an allowance for depreciation in collection. It is even better for auditing purposes to give these as. Accounts not yet due; due in thirty days, sixty days, past due and doubtful. The proper amount to carry in this account can be determined from sales. If, for instance, the firm is selling on thirty day credit, the accounts receivable should not be more than forty-five

days' sales. By taking the sales and dividing by 12, the average monthly sales may be ascertained; and since the accounts receivable are sales at the same prices, a month's sales on credit would represent a month's accounts receivable. In such a case the amount of *time sales* affords a better basis for comparison, but these figures are not generally given and the forty-five-day rule is the only one applicable. The character of the credits and the collection methods of the concern may be tested by an analysis of the accounts receivable. A firm that is freely extending credit and is lax in its collections will gradually expand its accounts receivable to undue proportions and create a large volume of slow and doubtful accounts. Many a firm has gone to the wall by reason of its accounts receivable absorbing not only its profits but also its own and its creditors' capital. The vital question here is. *How good are the accounts receivable and how fast are they being liquidated?*

Bills Receivable.—Prior to the introduction of the trade acceptance in American business the item of bills receivable in most statements was small. The greater part of mercantile credits was established through the medium of accounts receivable, or book accounts. Only such firms as sold goods on installment notes and a few others, where promissory notes were received in payment as a fixed policy, showed any large amount in this item. It would be expected in a concern such as a musical instrument house, selling pianos and talking machines on time payments, that sales would largely be represented by bills receivable. Likewise in electrical implements for household use, scales, cash registers, soda fountains, etc.

The trade acceptance, treated at length elsewhere, has, however, come into great favor with the business world and many firms that heretofore sold on book

account credit are now using the acceptance. Where such is the case, bills payable will be made up of trade acceptances and should be so stated. Where they are discounted at a bank, the item still appears as an asset, but the liability should include this amount as contingent. Bills receivable also hold anticipated profits and their quality should be investigated and any past due paper set up as an offset to the stated amount. Some firms carry their own paper and borrow on their single name in the banks. In such cases the bills receivable will be a pure asset with no offsetting liability.

In many statements will be found bills receivable taken from subscribers to stock and from others who have borrowed from the firm. Loans in this form are sometimes made to employees and officers, but ordinarily such are not well regarded among credit men.

Such assets might well be set up as secondary accounts only, since their collection would be slow. A mercantile firm should not lend its assets, this being a banking function and improper in a trading concern.

Merchandise.—The cash in a statement may easily be verified from first hand sources. The accounts receivable may be proven if necessary from the sales slips or by communication with the debtors The notes receivable may also be verified in the same manner But in the case of merchandise we have no element of first hand information and the test of this item lies largely in the integrity of the management. A large stock of miscellaneous goods can only be verified by an individual appraisal of each item, a physical impossibility in many instances.

During the war period of rising prices, merchandise was not a danger point in statements, inasmuch as a stock of goods was of constantly increasing value, and fortunes were made in the rise in commodity prices; but when

prices began to tumble with unheard of velocity and to unknown ends, the inventory became the pivotal point in all credit statements. Many of the war fortunes were reinvested in goods and were lost as quickly as they were made. During the deflation period following the war, well-managed concerns wrote off enormous amounts in depreciation of merchandise and the firm that did not make due allowance for depreciation of goods was open to suspicion; and the firm that showed a profit in 1921 was the exception and not the rule. Credit men preferred to have a oss shown for that year rather than a profit, knowing losses were the logical outcome of business conditions and profits quite impossible. In a rising market auditors are inclined to appraise merchandise at cost, and in a falling market cost or market, whichever is lower

Since it is obviously impossible for any auditing concern to make an independent audit of inventory, it is the custom to accept the appraisal of the firm. Occasional tests are made to determine the fairness of the appraisal and to prove extensions and summations. The auditor's certificate in this respect is usually qualified by stating that the inventory figures as made by the firm have been accepted, subject to the tests above mentioned.

The condition of the merchandise is also an important factor, especially in those goods which may become shop worn and obsolete on account of changing styles Old stock should be marked down to its fair value, allowing for a profit on subsequent sale Thus, if an article can be sold for $1 and the usual mark up of the firm is one-third, a fair price for inventory purposes will be 75 cents, which allows for marking up on sale to $1 and still show the selling profit of one-third on inventory prices.

Goods in process may be valued at cost plus the amount expended upon them to the date of inventory. Raw material may be carried at cost or market whichever is lower.

Inventory offers the unethical business man abundant opportunity to inflate his assets. An over appraisal, the inclusion of non-salable goods and juggling with figures are all avenues through which criminal practices are carried on.

Inventory deserves and is given the most careful consideration in all credit statements both by mercantile and bank credit men. Through it may be tested the merchant's real character and business morality. Having the total of the cash, good accounts receivable, notes and acceptances receivable, and inventory upon a cost or market basis whichever is lower, we have a true picture of what the firm owns in the way of quick assets with which it must carry on its business. This is its *working* capital as distinguished from *invested* capital in fixed assets. From the quick assets it must receive the daily inflow of cash to meet the daily demands made upon it for funds.

Merchandise on Consignment.—Merchandise out on consignment should not be represented by accounts receivable, for the goods have not yet passed into accounts. The proper way is to list this item as "merchandise on consignment" where the goods have gone out of stock and into the possession of other firms; while goods *received* on consignment should be listed as "consignment goods" with an offsetting liability of a contingent nature.

Quick Liabilities.—The quick liabilities are more easily and more accurately appraised than the assets and can be exactly determined. The first of which is:

Notes Payable to Banks.—The notes payable to banks should be set up in a notes payable register by amount and due date and should be verified by communication with the banks with which the concern does business. If it borrows in the open market the broker will have a record of outstanding paper and where held. This liability should not be accepted as stated in the books but independently checked as above suggested.

The notes payable to merchandise credits should also be shown in the notes payable register and may be audited by communication with the creditors. In some statements there will be found notes payable to officers, employees, etc. These represent loans made to the firm by relatives, friends and employees who are interested in the business and who prefer to invest money in this form for short or long time periods. Some high grade concerns show this item and while the practice is more or less common it is not the most desirable method of obtaining funds. Where the loans are pure accommodation and necessary to support an otherwise weak condition, it is an element of danger. Where a firm sells its paper in the open market it is advisable for it to keep its home lines open as an emergency measure, and many concerns pursue this policy.

If the home lines and the broker's line are both full it leaves the firm without borrowing facilities for those happenings which all well-managed concerns provide against. The seasonal requirements should also be taken into consideration in an appraisal of the notes payable, being heaviest when the manufacturing or trading demands necessitate large sums to carry the business over the peak of the selling period into the liquidation of its accounts receivable.

Accounts Payable.—As accounts receivable represent goods sold and delivered, so accounts payable represent

goods bought and not yet paid for. They may be checked against invoices, which in turn may be verified by communication with the sellers.

Various factors have a bearing upon the amount of accounts payable permissible. It is apparent that if the concern takes advantage of its discounts the invoices will be of short duration, and accounts payable will represent only invoices in process of audit. The sales come into play in this respect, for stock should be coming in as fast as it is sold in order to keep the supply adequate to the needs of the business. If a firm sells at the rate of $100,000 a month (cost price of merchandise sold) it should buy at about the same rate, and assuming the credit term be thirty days, there should not be on its books more than thirty days purchases; otherwise it is losing its discounts. If only ten days purchases were found, it would be an indication that the discounts were taken without further inquiry. An unduly large amount of accounts payable indicates that the firm is slow pay and is using the capital of its creditors in carrying on its business.

A firm which borrows on its notes payable should not have large amounts in accounts payable. Its borrowings are for the purpose of taking cash discounts and settling invoices, and if liabilities are carried in both forms something is radically wrong with the management.

Mark Up.—For the purpose of determining the cost of goods sold, it is necessary to know the standard "mark up" of the firm. All concerns have a fixed gross profit, or a minimum profit on goods sold. To the cost or inventory price is added this mark up. Sales therefore represent the cost of goods plus this mark up; and by dividing sales by 100 plus the mark up, we arrive at the cost of goods sold. Thus the sales are $300,000. The standard of mark up is one-third. By dividing

$300,000 by 133.33, we find the cost of the goods sold to have been $225,000.

Wages and Taxes Accrued.—Concerns employing help in large numbers will have a constantly accruing liability in the form of wages. Where the statement is taken off on a date that does not coincide with pay day, there will be the accrued wages from the last pay day This also includes salaries for the same period. This is easily estimated by taking the last pay roll and dividing by the number of days included, and multiplying by the number of days elapsed since the last pay roll was made up.

The income and profits taxes now levied by the government and other taxes levied by the state and local authorities are set up in "reserves for taxes" as a current liability The income taxes in some concerns have been heavy and unless provision is made by setting up a reserve, profits will be overstated. Practically all auditors now set up such a reserve. The real estate taxes may be approximated from previous years. Profits and income taxes must necessarily be estimated according to the results shown by the audit and the books. Where the government taxes are in process of adjustment with the tax officials and cover previous years, due provision must be made for such payments. In one large concern these back taxes amounted to nearly a million dollars and were the most serious problem the company had to face in a period of drastic reorganization.

Fixed Assets.—In considering the fixed assets, the credit man does so only as giving support to the liquid assets. If the statement does not warrant a line of credit as set forth in the current assets, he does not grant it at all. No bank or business house invites the necessity of realizing upon the fixed assets to recover for loans made or goods sold. The investments in fixed forms only

lend support to the liquid holdings of the business and strengthen the position already established in the liquid assets. Among the principal items of fixed assets are:

Land and Buildings.—It is necessary in many lines of business that there be an investment in land and buildings for the purpose of carrying on the business. Of such are manufacturing establishments, wholesale houses, mills, etc. that require specially located buildings for their use. These assets are usually set forth by themselves, and as a rule depreciation is set up in the statement. The valuation is best arrived at by an independent appraisal made by competent appraisers. There are several companies that specialize in appraisals of land, buildings and machinery. The cost or book value of such structures is an unreliable guide; construction may have been a war time measure and the cost much heavier than normally would be the case. A great many factory buildings were erected for filling war contracts and the cost was immaterial. In such instances heavy depreciation would be in order.

Many plants have been built for the sole purpose of housing the peculiar business and any reconstruction would be costly; therefore the limited utility must be considered in an appraisal of such specialized property. In some concerns the plant is the principal asset, as for instance in a knitting mill with its complicated and expensive machinery, wearing out rapidly and needing constant repairs and replacement, we would expect such a statement to contain a heavy plant account, but on the contrary in a department store, the stock may be more valuable than the equipment.

Machinery.—Machinery, as such, in a statement is not given much weight among credit men. Most of the equipment of plants consists of special machinery with a limited utility and has value only as second-hand articles

or as junk. Machines that are widely used and standardized, such as typesetting machines, shoe machinery, printing presses, etc. have a limited second-hand market. Ordinarily little attention is given to machinery in a statement, and it must show heavy depreciation charges. As a going concern the equipment is valuable; but in liquidation it has little hope of realizing more than bankruptcy prices.

Investments.—In many statements we find investments, itemized, but more often stated as a single item. Liberty bonds are found in a great many statements since the war and these are a most desirable asset. They can be turned into money immediately, or used as collateral for loans. More often, however, the investments are in subsidiary concerns, with which the parent company is affiliated. The earning power of these investments may be large, the security ample and the connection necessary; but such securities have a limited market and often no market at all. They are well regarded only so far as they bear close analysis favorably. In liquidation they would in many cases shrink heavily from their listed values.

It is not a good policy for a concern to employ its profits in speculative ventures. Excess profits may well be invested in Liberty bonds or other high grade securities; but the form of investment should be limited to securities with a ready market and sound intrinsic values.

Patterns, Patents, Dies, Etc.—It is customary to charge up against this account the cost of patterns, patents, dies, etc. These costs are often heavy and litigation costly to protect them. Undoubtedly they are worth something to the owner, for without them ideas could not be turned into articles. And without them the concern could not operate. A sale of the plant without

the patterns and dies would be a mere sale of real estate. Take a stove works, for instance. We would find an accumulation of patterns for stoves, ranges and parts running back a number of years. Many of these patterns have a wide market and parts are constantly in demand for repair purposes. But many are likewise no longer marketable and have no value whatsoever. Any statement which must depend upon so unsecure an asset would not be worth consideration. On the other hand, take for instance, the basic patents of the Kodak. These have made fortunes for their owners and without these patents the Kodak could not be made. And they could be sold for small fortunes to camera makers who can not now manufacture these articles.

Good Will.—Good will is either a most valuable asset or a worthless one. It has well been defined as "the tendency of trade to follow an established course." Or, it might be said to be the tendency of trade to follow a name or trademark. In selling even the smallest retail store, good will is provided for, if the business has been in existence long enough to have become established. Consider the value of *Uneeda* as typifying a soda cracker. We no longer ask for a pound of soda crackers—we ask for a package of "Uneeda Biscuit," and are willing to pay for a name, the advertising to keep it before the public, and the moisture proof package in which are wrapped our biscuits. We no longer ask for a camera—we ask for a Kodak. Illustrations might be multiplied indefinitely to show the transition of business as brought about by advertising a name in connection with an article. And to say that the good will that surrounds the name has no value, is to make a statement not based on business history.

Some concerns hold good will at a nominal amount, often as low as $1, while others hold it in very large sums.

In consolidations and mergers, good will is often placed at an amount based upon the ability of the company to pay dividends. Thus in selling out a candy business, it might be found that the business has earned enough in past years to pay 6 per cent on a million dollars annually. The seller will take a certain amount of cash and stock for the plant and business, and for good will a million dollars of stock in addition, in the expectation that the company will continue to earn enough to pay dividends upon this amount of capitalized good will. A certain bread company holds its good will at $5,000,000, on the assumption that its trade is worth that sum. A stove company in Detroit at one time held its good will at $4,000,000 out of total assets of $12,000,000.

On the other hand, the Goodyear Tire Company, whose good will and established name is worth a very considerable sum, holds its good will at $1. Many others do the same.

Treasury Stock.—Treasury stock is a term used to designate stock of the company held by the company and unissued; or it may be stock bought in the open market and held in the treasury. In order to arrive at the actual capitalization the treasury stock should be deducted from the outstanding capital.

Fixed Liabilities. *Capital Stock.*—The capital stock represents the contributed capital paid in by the stock holders; but inasmuch as it is allowable to issue stock for anything of value, it sometimes represents the purchase price of plant and machinery, good will, services, patents, trade marks, etc. The exact position of this item can only be known by an analysis of cash contributions received by the concern from stockholders.

The capital is presumably invested in the fixed assets and in the difference between the quick assets and quick

liabilities. The cost of the land, buildings, machinery, patterns, trade marks, patents, etc., should have come out of the stockholders and profits, and no part should ethically come out of borrowed money represented by notes payable and accounts payable. The net quick assets plus the fixed assets represent the capital, and if these items are allowable at the amount of the capital we have a well-balanced statement; but if the value of the assets is far less than the capital we have an element of "water" in the capital, and this is often the case.

Mortgages.—It is a principle of finance that long time borrowings for fixed purposes should be in the form of mortgages on the property, or bond issues secured by mortgages. The mortgage usually covers only the land and buildings and does not cover the machinery. The latter is provided for out of capital issues on the principle of "capital obligations for fixed investments, short time loans for current uses." The mortgage, in order to be safe to the borrower and not an element of risk to the, creditors should be long time and not of short maturity, making its renewal or extension a likely element of trouble in a stringent money market. Where bonds secured by a mortgage are issued, they are preferably amortized over a period of years and paid off in installments out of earnings. This eliminates the risk of having obligations mature in bulk, and at the same time places the management upon an efficiency basis in order to provide for the maturing installments

Debenture Bonds.—Many concerns have found it advisable to issue debenture bonds (unsecured obligations) instead of mortgage bonds, leaving the plant free of lien. Debentures sometimes take the place of commercial paper as a method of borrowing in the open market. During the war many concerns with free and clear plants issued five-year debenture bonds in order

to clean up all their bank loans and outstanding commercial paper.

Surplus.—A great many readers of financial statements give more credence to surplus than the item warrants. It must be clearly understood that surplus is merely a bookkeeping term to denote the difference between assets and liabilities. Assuming the assets to be conservatively appraised, and liabilities fully stated, the surplus should be a real surplus, representing earnings left in the business. It can, however, easily be raised by marking up the assets, and it may be concealed by marking them down. In a comparative statement, to find surplus growing from year to year in a sum approximating the net earnings is a healthful omen. And in a period of readjustment, such as we have just passed through, to find it diminishing is likewise a sign of conservatism. It is, in the last analysis, a balance wheel to take up the slack between assets and liabilities, and only a careful examination of all the elements of appraisal as evidenced in the assets will demonstrate whether it is to be given a place of honor or one of suspicion.

Contingent Liabilities.—The banker is greatly interested in the items under this head, and the auditor's report, or his notes, should show the following: Endorsements for subsidiary or allied companies; notes and accounts receivable discounted without recourse, but in connection with which there is an agreement to protect at maturity; contracts and surety agreements which involve large amounts; Federal income and excess profit taxes which are set up as a contingent liability over and above the known amounts paid or reserved for such taxes. If the books do not show any item for Federal income and excess profit taxes as a contingent liability, there is likely to be trouble in the final adjustment with the government, for without being in a cash position to

take care of the obligation, the borrower may find that he has to pay a large amount for taxes without having made any provision for taking care of such a contingency.

Reserves.—Under this head the auditor should see whether, in his judgment, proper reserves have been made for taxes, interest, bonuses, pay rolls, dividends, replacements, repairs, depreciation and obsolescence of plant, machinery, fixtures, etc.

Bonded Debt.—It is important for the auditor to give full particulars in regard to outstanding bonds, including dates, maturities and optional dates; the annual charge for interest, sinking fund or serial maturity requirements, and whether the mortgage covers personal as well as real property; also, whether all essential requirements of the bond issue have been complied with.

Capital Stock, Common Stock, Preferred Stock.—Details of the common stock are not of as great interest to the banker as those of the preferred stock—this for the reason that the necessity of paying dividends on preferred stock, in times of stress, is greater than on the common stock. Also, many preferred stock issues provide for a redemption fund and the banker wants to know the annual requirements for both preferred dividends and redemption fund. Then, too, many preferred stock issues carry a provision through which the common stockholders lose their rights to vote in case preferred stock dividends or redemption fund requirements are in default for a certain length of time. As a rule, those in the management own the common stock rather than the preferred stock, and therefore the banker is entitled to be advised whether under certain conditions the voting control and possibly the management is subject to change.

The auditor should ascertain whether dividends on the preferred stock are cumulative and whether any are in arrears, and, if so, the total amount. It should be ascer-

tained whether increases in capital stock were due to stock dividends or to actual money paid for stock.

Profit and Loss Statement.—It is perfectly natural for the banker to wish to know whether the borrower is making or losing money; therefore, the auditor should set up the profit and loss statement in great detail. A comparison should be made with several previous years Gross income from sales in the usual course of business should be shown separately from income from other sources. Income resulting from cash discounts should also be shown separately. Under no circumstances should the sale of capital assets be included in the profit and loss statement. It is rather a good practice to deduct from gross sales any amount resulting from cancellations or defective merchandise, as this conveys information to the banker which is valuable. The statement should include every item of expense, write-offs, depreciation, etc. The auditor should be careful to see that a different method of bookkeeping or of taking inventory does not show a false profit, and he should ascertain whether there are any special contracts soon to expire which have shown large profits in the past, and if, so, call attention to the fact in his report.

Other Items.—There are other items which should be set forth in the auditor's report—for example: Fire, liability and life insurance carried, giving the total amount of each, and the auditor's notes should contain full information covering the names of the companies issuing the insurance and the amount and character of each policy. In the case of life insurance, particularly, the annual amount required for premiums should be shown, as in some instances this may be quite a heavy charge against the operations. Also, the auditor's notes should contain a list of the principal officers and the amount of the salary of each.

It is difficult for an auditor, on his first examination, to secure any very definite impressions in regard to the management, but after he has made two or three annual audits, he should have definite impressions, if not knowledge, of the borrower's character, business ability and methods of doing business. If he should feel at liberty to do so, the information which he could give the banker with respect to these important matters, would be most valuable.

We will now apply the foregoing principles to actual statements. The name of the concern, the date of statement, and auditor's certificate are given fictitiously for obvious purposes. Our first statement will be a comparatively simple one.

Statement A. B. & X. Co.
Clothiers, Hatters & Furnishers
Connecticut

Dun Rating — B + 1
Bradstreet — KA

		February 1, 1924
Assets		
Cash	$ 23,806 71	
Accounts Receivable	37,554 94	
Merchandise	279,521 63	
Investments, Market Value	116,062 51	$456,945 79
Real Estate	$350,000 00	
Less Mortgages	193,000 00	157,000 00
Furniture and Fixtures		40,883 64
Investments		65,216 62
		$720,046 05
Liabilities		
Accounts Payable	$ 17,403 00	
Bills Payable	194,000 00	$211,403 00
Net worth		508,643 05
		$720,046 05

"Certified Correct" J E M, Inc C P A.
(Signed)

Analysis Statement A. B. & X. Co.—This is a retail firm of clothiers, hatters and furnishers. As such it would naturally be located in the business section of the city, and would require a considerable investment in fixtures; and if it did not own its own property its rental would be high. In this case it owns its own property, which may well be assumed to be located in the heart of the business section.

The *ratio*, $456,945 to $211,403 is 2.1 to 1.

Accounts Receivable—$37,554.94.—Not knowing the sales we cannot comment upon this item at length. The concern no doubt runs a charge department and this represents the unpaid accounts on the books.

Merchandise.—$279,521.63. The basis of this inventory is not given. The statement is taken in February, when the winter goods should be pretty well cleared from the shelves to make room for the spring trade. The firm has had its usual mark-down sales following the holidays, and should sell the left-overs at a sacrifice if necessary in order to have its stock clean for the coming season. The seasonable goods should be marked at a price that will realize a profit in a sale, or at their market value. Staple goods may be taken at cost or market whichever is lower. Inasmuch as prices are fairly well stabilized at the time this statement was taken, cost would probably be safe.

Investments—$116,062.51 *and* $65,216.62.—Upon a schedule of these investments, in a supplementary statement, they are found to consist of Liberty bonds $30,000, bank stock $19,240, savings bank accounts, War Savings stamps, railway stocks, real estate and mortgages, etc., showing a very good marketability and well selected.

Real Estate.—$350,000 less mortgages $193,000 – $157,000. On the assumption that the mortgage has been taken with the usual margin of safety, it is approxi-

mately 55 per cent of the stated value. This item appears to be conservatively stated.

Furniture and Fixtures—$40,883.64.—Presumably this represents the store fixtures. This item would shrink considerably in liquidation; and whether this is cost or depreciated value is not stated. However, a heavy investment in store fixtures is proper for a concern of this kind.

Total Assets—$720,046.05.—According to the rule that only concerns of half a million net worth should seek the open market, this concern qualifies.

Accounts Payable—$17,403.—This is relatively small. The firm no doubt takes its trade discounts and has cash on hand sufficient to pay off these items and still have a small working balance. Its cash position would seem to be good.

Bills Payable—$194,000.—Whenever this item appears in round amounts it indicates that the concern borrows in the open market on commercial paper. If the item is an odd amount, it sometimes indicates that it gives notes or acceptances. If the amount were $195,000, or any multiple of $2,500 or $5,000 we would be certain that this is all commercial paper. The $194,000 would lead to inquiry. It may have some $1,000 pieces outstanding.

Net Worth—$508,643.05.—Part of its net worth is in the building and equipment and part in the other assets.

"*Certified Correct—J. E. M. Inc. C. P. A.*"—This is an audited statement, but the certificate is general, not specific. It would be more acceptable to have a certificate as found in subsequent statements (which see). The partners are stated to be worth $150,000 outside the business and carry $320,000 life insurance. The concern has been in business forty years.

General Comment.—This is a fine statement. The firm has good investments to fall back upon in time of need, and in the event of death of either partner, the life insurance will make it unnecessary to liquidate the business. The profits have been left in the business and invested for the firm account. It could liquidate a very large part of its indebtedness without sacrificing stock and its position is admirable.

However, it would be better financing if this firm used its own resources, now invested in stocks and bonds, in carrying its own credits. It may be borrowing in the open market for the purpose of establishing its credit, and this is a good policy.

Checking Letter

A B & X Co

Referring to your inquiry of the 8th instant concerning Messrs A B & X., have to advise that the firm mentioned has carried a very satisfactory account with this trust company for the past seven or eight years We have, at all times, been willing to extend the company accommodation in accordance with its requirements to the limit allowed us by law. From their latest financial statement, as of Feb 1, 1924, they show a net worth of $508,643 05, quick assets of $456,945 79 as against current liabilities of $211,403 00 or a ratio of more than 2 to 1 Their quick assets are made up of cash, $23,806 71, accounts receivable $37,555 00, merchandise, $279,522 00 and investments $116,062 00 The investments are all of a liquid nature with the possible exception of about $3,000 and are made up of Liberty bonds, War Savings stamps, savings accounts, bank, telephone, illuminating and railroad stock.

This information is furnished in confidence, in response to your request, and is to be accepted by you without recourse to this institution or the undersigned

Very truly yours,

V B J

Treasurer.

Statement H. I. J. Co.

Mfrs Cocoa and Chocolate
New York

Dun Rating—AaA1
Bradstreet—G Aa Jan 1, 1922.

Assets

Cash		$ 240,503 65	
Accounts Receivable		352,259 28	
Notes Receivable		21,300 00	
Merchandise Inventory		1,119,183 29	$1,733,246.22
Real Estate, Buildings, Machinery and Fixtures		$2,332,325 73	
Less Depreciation		676,795 35	1,655,530.38
NOTE The Standard Appraisal Company under date of March 22, 1921 appraised the above at	$2,440,270 50		
Additions since appraisal	39,126 55		
Total	$2,479,397 05		
Automobiles—Less Reserve for Depreciation		$ 22,711 94	
Advances to Salesmen and Employees		1,371 47	
Collateral Notes from Customers		220,000 00	
Securities Owned		43,486 42	
Cash Surrender Value—Life Insurance		2,415 00	
Good Will, Trade Marks, etc		738,875 89	
Treasury Stock (1,024 shares Preferred par $100 00)		72,659 00	1,101,519 72
			$4,490,296 32

Liabilities

Loans Payable	$ 400,000 00	
Accounts Payable	86,284 53	
Sundry Loans and Deposits	8,877 03	
Personal Credit Balances	12,009 40	
Expense Accrued	14,367 02	$ 521,537.98

Bonds Payable—6 per cent Serial Bonds, 1927 .			449,583 50
Mortgages Payable			39,250 00
Reserve—Bad Debts			10,000 00
Machinery			20,000 00
Preferred Stock—Authorized $4,000,000—Issued			2,210,500 00
Common Stock—Authorized 40,000 shares—no par applicable to 40,000 shares—no par value stock			1,988,953 99
Total			$5,239,825 47
Surplus—			
Balance—Jan 1 1921	$ 7,586 17		
Add· Forfeitures on account of Stock Subscriptions	173,043 00		
	$ 180,629 17		
Dividends	174,299 34	$ 6,129 83	
Loss for the year ended Dec 31, 1921 .		755,858 98	
Deficit—Dec 31, 1921			749,529 15
			$4,490,296 32

This is to certify that we have audited the books of H I J Co for the calendar year 1921 and that the attached Statement of Assets and Liabilities as of Jan 1, 1922 reflects, in our opinion, the true financial condition, as of that date

In preparing these statements we have accepted the valuations placed upon Inventories by the Officers of the Company

(Signed)
F E. R.
Certified Public Accountant

SALES—$3,291,045 80 After charging off general depreciation, all bad debts and depreciating their inventory to the lower of cost or market, the company showed a net loss of $755,858 98

ENDORSED—H I J, adding an outside worth, we are advised of $75,000

BANK ACCOUNTS—National Park Bank, New York, N. Y.
National City Bank, New York, N. Y.
Hanover National Bank, New York, N Y.
Nassau National Bank, Brooklyn, N. Y.
Brooklyn Trust Company, Brooklyn, N Y

Statement Analysis H. I. J. Co.—This is the statement of a well-known firm of chocolate and cocoa manufacturers. It has several interesting features.

The ratio is $1,733,246 to $521,537, or 3.3 to 1.

Sales $3,291,045.80, or approximately $275,000 a month

Cost of goods sold, allowing a gross profit of one third is approximately $2,500,000, or at the rate of $208,000 a month.

Cash—$240,503.65—a strong cash position.

Accounts receivable—$352,259 28 or about five weeks' sales. This also is favorable.

Notes receivable—$21,300, are unaccounted for except as taken for old accounts.

Merchandise—$1,119,183 29.—Some of this is finished, some in process and some raw. It is stated in the closing comment that, depreciating inventory to cost or market whichever was lower, the company showed a deficit of $755,858.98 for the year. This is a heavy loss and was probably due to sugar and cocoa contracts taken at high prices and which the firm honored. They probably got caught in the deflation following the war, and this is the result. They have taken their losses and started anew. This is good policy, but costly, and inevitable under such conditions as obtained at the time. They have a five months' stock of goods on hand. Being non-perishable and a necessity of life it can be held until marketed.

Real Estate, Buildings, Etc—$1,655,530.38.—In such a concern we would expect a heavy investment in plant, and such is the case. It has been scaled down about 25 per cent. An independent appraisal places the value at more than the book figures.

Automobiles, used for trucking, etc. have also been scaled down to $22,711.94.

Advances to salesmen, $1,371.47 are nominal.

Collateral notes from customers—$220,000 are large enough to warrant inquiry. The broker can possibly explain this item.

Securities owned—$43.486 42 are not scheduled and the quality is therefore unknown.

Life Insurance, Surrender Value—$2,415.—This is no doubt a policy running to the company and taken on the life of one of the officials. Many firms are now carrying such insurance and paying for the same as an expense In a sense it is cashing in the worth of a man at his death.

Good Will, Trade Marks, Etc.—$738,875.89.—The value of this item is open to question. The firm has an established name and its brands are well known. This item represents about 17 per cent of the total assets. Whether it is a proper asset at this figure cannot be stated without a full inquiry into the real value of the good will as reflected in a continuity of its trade.

Treasury stock—$72,659 is the value of the unissued stock.

Loans payable—$400,000 is the commercial paper outstanding at the time of the statement.

Accounts Payable—$86,284.53.—The cost of goods sold was found to be approximately $200,000 a month. This item represents about thirteen days' sales, showing the firm to be taking its discounts.

Sundry accounts payable and deposits, personal credit balances, while not large (about $20,000), are not explainable from the statement, except the item of personal credit balances, which no doubt represents amounts due to officers of the company.

Expense accrued—$14.367.02 represents expenses accrued but not yet due, or due and unpaid.

Bonds payable in 1927—$449,583.50 have several years to run and are not an element of danger at the present time.

Mortgages payable—$39,250 are small in comparison to the value of the plant. This has no doubt been built from the proceeds of the stock issues.

Reserves for machinery and bad debts are $30,000

Stock issues—$2,210,500 and $1,988,953.99 show a heavy capitalization, which has gone into the plant and other working assets, and the property is reasonably free of debt.

The *surplus* is practically nil—$6,329.83, but the dividends have been substantial—more than the profits would warrant. The loss for the year is $755,858.98. The company has had a bad year, but it has cut to the bone, and makes no effort to conceal its position in this respect.

The paper bears a personal indorsement with a worth of $75,000 outside the business, which lends some support to the paper.

General Comment.—The liquid position is good, the cash ample and the statement is a good one in spite of the losses taken. The plant (from personal knowledge) is well located, substantially built and has a large equity. The dividend of $174,299.34 was not warranted on account of the heavy loss for the year. The company is in position to meet its current debts and its funded obligations have several years to run It would be a safe risk.

Checking Letters

H I J Co

In response to your inquiry of the 15 instant, Messrs H I J Co are old and valued dealers of ours, having carried a very nice account with us for several years

We give them a line up to our legal limit which is used but sparingly, is properly handled and paid out periodically They were off our books for three months last year and are availing themselves of half of their line at the present time

In common with others they felt severely the effects of the slow down in business last year as the result of which their operations for the year showed a considerable loss Their statement, however, at the end of the year shows a good proportion of assets to liabilities, and we believe them perfectly good for their obligations

The management is well known to us, is energetic and progressive and we have no hesitancy in extending them credit

Very truly yours,
T S. R
Vice President

We hold a very good opinion of H I J Co While they had a pretty hard time last year, they used us only for a period of six months and were entirely out of debt here from October last until yesterday, when we loaned them $150,000 The Company always carried good balances and has enjoyed the confidence of their banking and trade friends. Following the recent death of Mr Blank, we are informed the Vice President and Treasurer will in the future endorse the paper and that these endorsements will carry an equal, if not a greater, financial responsibility

Yours very truly,
E. N T
Mgr Credit Dept

The business of H I J Co , inquired about in your letter of May 15, was established many years ago and the company is now generally regarded as one of the leading manufacturers of cocoa and chocolate in this country

It has been a depositor of ours since 1910 and our experience throughout has been of a satisfactory character, although we have found the company an infrequent borrower and it has not asked us for credit favors since June 1921

It has been reported to us that Mr Blank, formerly President of the company, recently passed away, but it is the general feeling that he had built up a good organization and we have always heard the management spoken of as capable and resourceful. When we made general inquiries on the name a short time ago, the information we obtained from trade and banking circles was of a favorable character and we furthermore note that the company's financial statement as of Jan 1, 1922 showed a ratio of current assets to current liabilities of over 3 to 1 with cash and receivable items sufficient to discharge current liabilities

Very truly yours,
F S. K
Assistant Cashier

Statement D. E. F. Co

Importers and Jobbers of General Merchandise

New York, N. Y

Dun Rating — AaA1 Dec. 31, 1923
Bradstreet — H Aa

Assets

Current Assets.			
Cash in Banks and on Hand		$ 25,440 94	
U S Government Liberty Loan Bonds, Notes War Savings Stamps		8,586 80	
Accounts Receivable .		857,908 08	
Notes Receivable .		4,345 88	
Trade Acceptances Receivable	$ 21,264 15		
Less Trade Acceptances Discounted	18,285 07		
Equity in Trade Acceptances		2,979 08	
Due from Officers ..		9,563 43	
Due from Salesmen and Employees		6,074 45	
Dividends Receivable		131 25	
Trading Assets			
Merchandise Inventory "Cost or Market whichever lower"	$779,911 69		
Foreign Currency Deposits in Hand of Agents (for Purchase of Merchandise only)	112,982 80	892,894 49	$1,807,924 40
Fixed and Other Assets.			
Loans and Advances		$ 19,300 00	
Investments—Stocks and Bonds—Book Value .		13,160 00	
Furniture and Fixtures—Book Value		5,007 27	
Prepaid Items and Accruals		3,232 66	40,699 93
			$1,848,624 33

Liabilities

Current Liabilities:			
Accounts Payable—Trade		$150,597 07	
Trade Acceptances Payable Domestic .	$ 5,380 20		

Under Letters of Credit . .	47,561 11	52,941 31	
Notes Payable to Banks		150,000 00	
Merchandise Advances		27,735 26	
Dividends Payable		21,875 00	
Due to Officer		15,861 36	
Due to Employees		2,000 00	$ 421,010 00
Other Liabilities:			
Loans Payable		$ 40,801 81	
Due to Old Partnership		1,156 64	
Affiliated Company		12,725 43	54,683 88
Total Current and Other Liabilities			$ 475,693 88
Reserves·			
Discounts	$	9,441 23	
Depreciation Furniture and Fixtures		4,157 05	
Commissions		1,459.12	
Bad Debts		7,035 35	
Professional Services		2,000 00	24,092 75
Capital Stock			
Authorized Issued and Outstanding			
Preferred and Cumulative 7 per cent 12,500 shares at $100 00 par value each		$1,250,000 00	
Common			
2,500 shares at $5 par value each		12,500 00	1,262,500 00
Surplus			86,337 70
			$1,848,624 33

Pursuant to engagement, we have audited the accounts of *D E F.* Co for the year ended December 31, 1923 and,

We hereby certify, that in our opinion, the accompanying Balance Sheet correctly sets forth the financial condition of the company as at Dec 31, 1923

(Signed)

Public Accountants

SALES—$6,047,625 75 NET PROFITS—$149,110 77

DIVIDENDS—$87,500.

BANK ACCOUNTS—Atlantic National Bank, New York, N. Y
Bank of the Manhattan Co , New York, N. Y
Bank of the United States, New York, N. Y

Analysis Statement D. ·E. F. Co.—The ratio of this statement is $1,807,924 to $421,010 or 4.3 to 1. This is an unusually high ratio.

The sales are $6,047,625, or about $500,000 a month. Allowing a mark up of one-third, the cost of goods sold was about $4,500,000.

Accounts receivable are $857,908.08 or less than two months' sales. Not knowing the terms of sale in this concern we cannot pass on this item, but generally speaking this figure would seem to be normal.

Notes Receivable—$4,345.88 —Inasmuch as this firm takes trade acceptances for current sales, it may be presumed that these notes represent past due accounts This item is however insignificant

Trade Acceptances—$21,264 15, *Etc.*—The firm is using trade acceptances to a limited extent, discounting them in the banks and sets up the amount discounted to show the disposition of these instruments. This is proper.

Due from Officers, Salesmen, Etc.—$9,563.43 and $6,074.45.—The firm is lending to its employees and taking their notes. The reason for this is not stated. Advances to salesmen on account of commissions is permissible; but advances to officers is not a proper procedure. It indicates that they are drawing against future salaries.

Merchandise—$779,911 69 at "cost or market whichever is lower." This is proper and properly stated.

The cost of goods sold runs about $400,000 a month, and the firm has two months' supply of merchandise. It also has two months' sales on its books. This indicates that it is selling as fast as it buys and turns stock six times a year, which is commendable.

Foreign currency—$112,982.80, probably means cash in the hands of foreign buyers.

Loans and advances, investments, etc. not being itemized we have no way of knowing their value The amounts are relatively small.

Furniture and fixtures—$5,007.27—a nominal sum. Being wholesalers, the firm does not need elaborate equipment for display, and this modest figure shows good judgment.

Accounts Payable Trade—$150,597.07.—We found that the firm buys at the rate of about $400,000 a month. The amount due on accounts payable is therefore less than one-half a months' purchases, indicating quite conclusively that it takes its discounts.

Trade Acceptances Payable—$52,941.31.—The firm has purchased some merchandise on the acceptance plan and this indicates the liability on account of it.

Notes Payable to Banks—$150,000.—The words "to banks" would indicate that this item is commercial paper outstanding; although borrowings from home bank may be included

Merchandise advances—$27,735.26 indicates that the firm has received advance payments on account of merchandise sold and sets up this liability to show its obligation on account of such transactions.[1]

Dividends Payable—$21,875.—This is the amount of dividends payable at the time the statement is taken off and is a proper accounting procedure.

Due to Officer—$15,861 36.—This item is sometimes found in statements where one of the members loans the firm money or allows profits or salary to accumulate. It would not seem necessary for this firm to borrow of its officers Frequently members of the firm or their

[1] If this item represents merchandise purchased, it should be carried as an "account payable."

families prefer to have money invested in the firm, as a loan, to other forms of investment.

Due to employees—$2,000 is probably of the same nature as the foregoing item.

Loans Payable—$40,801.81.—This item cannot be explained without inquiry of the firm itself. It may be of the same nature as the two items just mentioned

Due old partnership—$1,156.64 is undoubtedly a small unadjusted item due the former management.

Due Affiliated Company—$12,725.43.—The nature of this is not self explanatory.

Reserves—$24,092.75.—The company has set up reserves for discounts to be taken by customers, commissions, furniture and fixtures, bad debts, and legal services, which is proper and commendable.

The capital—$1,262,500 is substantial—two thirds the quick assets.

Surplus—$86,337.70 is not commensurate with the capital. A bad year would cut heavily into this item and impair the capital.

Net profits—$149,110.77 are a little over 2 per cent on sales, not a large return. The management must be economical and efficient, credits well in hand, losses carefully avoided, or the net profits will shrink to a negligible figure.

Dividends—$87,500, are 7 per cent on the preferred stock as per agreement.

General Comment.—This is a good statement. The liquid position is strong. The current debts are small in comparison with the current assets, and the creditors are well protected. The stockholders, however, are not so well protected, and the company for the current year, at least, is paying out more than half its net profits in dividends. The paper is a safe purchase. Being

audited by a well known firm and of recent date the figures may be accepted as stated.

CHECKING LETTERS D E F Co

The D E. F. Co has maintained a very good and entirely satisfactory account with our Atlantic Office for a number of years and we are pleased to grant them a liberal line of accommodation on their own paper without any endorsements They are not steady or excessive in their borrowings and at all times maintain balances commensurate with their commitments

Their financial statement of December 31, 1923 indicates progress and ample quick assets to pay business liabilities

Yours very truly,
A. B X
Credit Manager.

We have yours of the 22nd regarding the D E F Co

In reply, beg to state that we have been favored with this concern's account for the past year and a half The personnel is very well known to us and enjoys our fullest confidence which is evidenced by the fact that we accommodate them on their straight corporate note to the extent of $200,000. At this writing they are out of our debt entirely and they maintain excellent balances

Investigations through trade and banking circles, periodically, disclose nothing of an unfavorable nature and due to our favorable relations with them we recommend the purchase of their paper as a safe banking investment

Very truly yours,
G S S
Credit Manager

Statement of the X. Y. Z. Drug Co

Mfrs. & Whol of Drugs

New York, N. Y.

Dun Rating—AaA1
Bradstreet—G Aa Dec 31, 1921

(After giving effect to an issue of $500,000 First Preferred Stock consummated as of April 1, 1922)

Assets

Current.		
Cash in Banks and on Hand		$ 97,024 93
Accounts Receivable—Trade	$924,681 59	

Accounts Receivable—Miscel .	8,833 89	933,515 48	
Notes Receivable—Trade	$ 12,546 78		
Notes Receivable—Miscel	14,746 00	27,292 78	
United States, Municipal and Railroad Bonds (Market Value $120,964 92)		122,768 62	
Inventory of Raw, Semi-finished and Finished Merchandise		2,030,402 91	$3,211,004 72
		3,113,979 79	
Deferred			
Inventory of Advertising Matter, Salesmen's Samples, Printed Matter, etc		$ 57,407 31	
Insurance Unexpired		10,348 56	67,755 87
Fixed			
Land		$ 126,859 26	
Plant—Land and Buildings		609,894 22	
Machinery and Equipment		284,620 37	1,021,373 85
Investments in Other Companies (at Cost)			
The Chemical Corporation		$ 389,681 33	
T P Publishing Co		18,000 00	407,681 33
Good Will, Rights, Formulae, etc			574,348 36
			$5,282,164 13

Liabilities

Current		
Accounts Payable—Trade, etc	$ 306,527 25	
Preferred Dividend Payable, Jan 3, 1922	17,500 00	
Notes Payable—Banks and Bankers	912,500 00	
Notes Payable—Miscellaneous	21,000 00	
Accounts Payable—Stockholders and Relatives, Employes, etc	272,165 95	$1,529,693 20

Liabilities. Current—Brought Forward		$1,529,693.20
Deferred:		
Account Payable—Tooth Powder Rights (payable in equal installments over ten years)		66,666 66
Mortgages Payable		
On Plant—Land and Buildings—due Dec , 1924, installments payable $5,000 00 semianually		195,000 00
Reserves:		
For Depreciation of Plant Buildings	$ 66,538 50	
For Depreciation of Machinery and Equipment	109,324 88	
For Bad and Doubtful Accounts	50,000.00	
For Notes Receivable	14,146 00	240,009 38
Capital Stock:		
7 per cent First Preferred—Authorized—5,000 shs of $100 par, all outstanding	$ 500,000 00	
7 per cent Second Preferred—Authorized—10,000 shs of $100 par, all outstanding	1,000,000 00	
Common—Authorized—30,000 shs all outstanding at a paid in value of	1,515,299 81	3,015,299 81
Surplus		235,495 08
		$5,282,164 13

We have made an examination of the books and accounts of X Y Z Drug Co , as at Dec 31, 1921, and we hereby certify that the above Balance Sheet is correct as stated

The Inventories have been certified to us as being at cost or market, whichever is lower, and appear to have been correctly compiled. In our opinion proper Reserves have been created for Depreciation and for Bad and Doubtful Accounts

(Signed)

T D & P
Auditors

This business was established over seventy years ago and has enjoyed an unbroken record of success The partnership which had existed for many years was succeeded on Jan. 1, 1917 by the present Corporation, chartered under New York laws The Officers of the Corporation are all active in the business and include the former partners

The house of X Y. Z. Co. is recognized as one of the best known houses in the drug trade, having a well-established clientele throughout the entire country

Amounts due stockholders, relatives and employees represent deposits, a large percentage having been on deposit with the Company for a period of years

The company's volume for 1921 was over $6,000,000

BANK ACCOUNTS—National City Bank, New York, N. Y
Equitable Trust Co , New York, N. Y
The Bank of America, New York, N. Y
Chemical National Bank, New York, N Y
Irving National Bank, New York, N. Y
(Market and Fulton Branch)
The Bank of New York, New York, N Y

Analysis X. Y. Z. Drug Co.—This is an old and well-known firm of wholesale druggists. It has been established over seventy years and has enjoyed unbroken success. The sales for 1921 were over $6,000,000 or $500,000 a month. The ratio is $3,211 to 1,529 or 2.1 to 1.

The cash is substantial, and in handling this volume of business a large cash balance is necessary.

The accounts receivable are $933,515.48 or about two months' sales.

The notes receivable are but $27,292.78, a nominal amount. The company has used part of its profits to purchase high grade securities in the sum of $122,768.62. It has therefore a secondary reserve to fall back upon in case of need and could use these as collateral or sell outright. The merchandise—$2,030,402.91 is certified to by the auditors, as carried at cost or market whichever was lower. Such a stock will not deteriorate and most of it is staple. On a mark-up of one-third, the cost of goods sold is about $4,500,000, or about $400,000 a month. There is therefore a five months' supply of merchandise on hand. Stock is turned about two and one-quarter times a year.

Inventory of Advertising Matter Etc.—$57,407.31.—The advertising expense in the form of booklets, etc., samples of goods for salesmen's use has been set up as a deferred asset. The costs have been charged to expense account and a deferred asset in this form set up. This is essentially an inventory of printed matter, presumably at cost. It is valuable only to a going concern.

Insurance Unexpired—$10,348.56.—It is customary to hold the unexpired insurance premiums as an asset. The premiums are paid as a rule for three years in advance, and the amount for the unexpired term is ascertained and carried as unexpired insurance.

The land, buildings and equipment are carried at $1,021,-373.85. Depreciation is set up as a liability on the other side at $175,863.38. The conservatism of this item cannot be stated from the information submitted.

The company has invested $407,681.33 in other companies as mentioned, at cost. This is usually done for the purpose of controlling the output, thus making one concern dependent upon another. Such investments may or may not have great value; but as a rule the interlocking interests make such investments more valuable to the controlling company than would be the case if they were independently operated. The selling facilities of the parent concern in this instance will make a subsidiary company sure of its market at a minimum of selling expense.

Good Will, Rights, Formulae, Etc.—$574,348.36.—This concern has an established name, valuable preparations and a long history. It is seasoned, and the trade that will follow the name without regard to the personal element is exceedingly valuable. This item does not greatly strengthen the statement, neither does it injure it.

Liabilities:

Accounts payable—$306,527.24 are less than a month's purchases and indicate that the firm takes its trade discounts.

The dividend—$17,500 is payable at the time this statement is taken and is properly set up as a liability.

The notes payable to banks—$912,500, in round amount, are substantial, but less than one-third the quick liabilities.

The miscellaneous notes payable—$21,000 are not explained.

Accounts payable to stockholders, employees etc—$272,165 95 are explained by the auditors, in stating that a large part of these advances have been carried for a long time.

It is evident that this firm enjoys the confidence of those who are affiliated with it and its friends who have placed their funds in its care as a permanent investment. Such is often the case.

Accounts payable—rights (for a popular brand of tooth powder) $66,666.66 are payable over a period of years and are not in position to embarass the company in any way. These rights have evidently been acquired on a part payment or royalty basis.

Mortgages Payable—$195,000.—The book value of the land and buildings is $736,000, and on this basis the mortgage is nominal. The due date of this mortgage is important in showing when this liability must be met or extended. As a mortgage for one-third the value of the property it would not ordinarily be difficult to place, but in an adverse money market all mortgages are difficult to obtain except at excessive costs.

Reserves—$240,009.38.—The reserve for depreciation of plant and machinery has already been commented upon The reserve for bad debts would seem to be

substantial—$50,000, and for notes receivable $14,146 equals one-half the amount carried. The company has three classes of stock, preferred—$500,000, second preferred—$1,000,000, and common of no par value, held at $1,515,299.81. The process of issue of the last mentioned stock would show the value received for it. The stock issues are nearly equal to the total quick assets and nearly three times the fixed assets.

Surplus—$235,495.08 is not large for so large a concern and a bad year would seriously cut into the surplus but considered as a whole the statement is a good one.

CHECKING LETTER X Y. Z DRUG CO

In answer to your letter of the 8th instant, X Y Z Drug Co. (Wholesale Drugs) this city, are one of our old and valued customers. The business is directed by capable and experienced men whom we regard favorably as to their character and ability and as you may know, the concern is one of the oldest and most prominent in this line of business.

Their statement of Dec 31, 1921 claimed a net worth in excess of $2,300,000 and while a rather heavy debt was reflected, we are informed that they have capitalized $500,000 of their liabilities which puts the figures on a more attractive basis Our impressions of the company have always been entirely favorable and we are pleased to extend credit up to $150,000 to 200,000 of which only a part is being employed at this time

In view of the foregoing, in our opinion the concern is entitled to your confidence

Yours very truly,
G. H P.
Assistant Manager

Statement W. V. G Co.

Publishers
New York, N Y Dec 31, 1923

Assets

Cash	$ 32,483 07	
Accounts Receivable	790,593 39	
Merchandise	116,728 16	$ 939,804 62
Furniture and Fixtures		21,003 13
W V G Publications		283,375 09

Affiliated Publications		592,086 00
Deferred Charges		38,946 40
		$1,875,215 24

Liabilities

Bills Payable	$294,000 00	
Accounts Payable	54,523 23	
Accrued Charges and Reserves	5,026 12	$ 353,549 35
Surplus and Undivided Profits		191,115 89
Capital Stock-Preferred	$335,630 00	
Common	994,920 00	1,330,550 00
		$1,875,215 24

(Signed) W. V G , Co
By W V G , Pres

SALES—$885,890 47 PROFITS—$73,197 53 DIVIDENDS—$11,752

BANK ACCOUNTS—Chemical National Bank, New York, N Y
Metropolitan Trust Co , New York, N Y
Continental & Commercial National Bank, Chicago, Ill

Analysis W. V. G. Co.—This is a publishing house, publishing several magazines and a variety of books sold on the installment plan. The business was organized in 1906 with paid in capital of $12,000. Fifteen years later it was incorporated in Delaware with authorized capital of $2,000,000, of which $750,000 is preferred and $1,250,000 common.

Ratio—$939,804 to $353,549 or 2.6 to 1. This is satisfactory, provided the other items analyze well.

Accounts Receivable—$790,593.39.—We find the sales to be $885,890.47 for the past year—an average of about $74,000 a month. It has therefore over ten months' sales on its books. In selling books on installments, it is expected that the term will run about a year and this bears out such assumption. These accounts being payable in installments, are not a quick asset, but reasonably sure of collection, with the usual losses incident to such business.

Merchandise—$116,728.16.—This consists no doubt of books. The book sales not being given separate from magazine receipts, we cannot estimate the turnover, or the sufficiency of stock. As long as they are successful in selling through their sales organization, the value of this merchandise will remain stable; but as soon as selling is curtailed its value will shrink heavily. (As a matter of fact the author has a set of the books featured in this statement; and at the time this analysis was made, he was in receipt of an offer from a New York house of large wealth, offering this set at a nominal figure.)

Furniture and Fixtures—$21,003.13.—This no doubt represents the office equipment, and its worth cannot be told from the figures as submitted. It would properly be excluded in passing upon the credit risk.

The W. V. G. Publications—$283,375.09 represent books in sets and ready for delivery The basis of this inventory is not stated.

Affiliated publications—$592,086 represents the magazines and other publications, but the basis of these figures is not given and therefore no opinion can be expressed concerning this item.

Bills Payable—$294,000.—It would seem that this firm has borrowed in the open market in order to finance its accounts receivable. Commercial paper has been turned into reasonably long book accounts. The firm cannot clean up at any time, for it must constantly borrow in order to finance its time payments.

Accounts Payable—$54,523 23.—This item is not large and would indicate that the firm takes its discounts and pays promptly. With a gross profit of one-third, the cost of goods sold is $666,000—an average monthly charge of about $50,000 It has one month's purchases unpaid for

The nature of *deferred charges* $38,946.40 and accrued charges and reserves $5,026.12 cannot be determined from this statement as set up.

Capital stock issued—$1,330.550.—This makes the investment of the stockholders substantial and many times the debt in the open market.

These capital contributions have gone into books, magazines and installment accounts, with all the risk involved in the publishing business. It is not supplying a necessity of life and the sales must be made through an expensive selling organization that takes the goods to the consumer.

Profits—$73,197.53.—This is about 8 per cent of sales, out of which dividends of $11,752 have been paid on the preferred stock, or about 3 per cent. This statement is not audited, and makes no provision for profits taxes for 1923.

General Comment.—While the ratio is proper, I do not like the aspect of this statement The business is risky, and subject to many hazards. The net profits are about 5½ per cent on the capital, too close a margin for the stockholders' good. The accounts receivable will surely shrink in their collection, and while the surplus $191,115 89 would indicate profits had been substantial, these accumulations have been only about $12,000 a year. From the nature of the business and the fact that this statement is unaudited, I would not buy this paper, whatever the bank checking might be

Statement B. J H. Co

Dun Rating—B + 1	(Mfrs Shoes)	
Bradstreet—J A	New Jersey	Dec 31, 1921.

Assets

Current Assets	
Cash in Banks and on Hand	$13,356 68
Notes Receivable	18,779 16

Accounts Receivable—Customers			
Domestic	$172,659 55		
Cuban	28,926 44		
Controlled Shoe Stores	79,671 12		
Sundry Employees	333 34		
		281,590 45	
Advance Payments on Purchases		120 76	
Investments			
United States Victory Loan Bonds—Par	$ 2,150 00		
Capital Stock of United Shoe Machinery Co — at par	1,800 00	3,950 00	
Inventories			
Finished Goods	$ 98,296 48		
Goods in Process	36,743 23		
Materials and Supplies	165,823 19	300,862 90	$618,659 95
Charges, etc Deferred to Future Operations			
Advances to Employees on Accounts of Commissions and Salaries Deferred to Future Operations		$ 14,007 41	
Prepaid Interest		1,335 31	
Accrued Dividend		36 00	
Unexpired Insurance		4,426 42	19,805 14
Investment in Shoe Stores			
Capital Stock		$ 39,608 00	
Loan to Manager of Sullivan Co (Secured)		1,900 00	41,508 00
Fixed Assets (Less Depreciation)			
Real Estate and Buildings		$176,330 38	
Machinery, Equipment and Office Furniture		71,514 65	
Lasts		6,000 00	253,845 03
			$933,818 12

Liabilities

Current Liabilities		
Notes Payable	$160,000 00	
Accounts Payable	20,335 72	

Customers' Advances for Purchase of Merchandise . .	2,035 68	
Accrued Wages, Interest, Liability Insurance, etc	3,323 97	$185,695 37
Special Deposits of Officers and Others		104,948 64
Mortgage on Real Estate		42,000 00
Capital Stock		
6 per cent Cumulative Preferred (Authorized $500,000 00—Issued and Outstanding .	$ 86,200 00	
(Dividend paid to Aug 1, 1921)		
Common (Authorized $500,000.00)—Issued and Outstanding	300,000 00	386,200 00
Surplus		214,974 11
		$933,818 12

CERTIFICATE OF AUDITORS

We have examined the accounts of the B J H. Co , New Jersey, for the purpose of verifying the assets and liabilities as at Dec 31, 1921, and have compiled therefrom the foregoing Balance Sheet, which is in agreement with the books

The notes and accounts receivable are considered to be collectible, all known bad accounts having been written off Responsible officials of the Company have certified to us that the inventories were carefully taken and are correct as to quantities and valuation. We have verified the clerical accuracy of the inventories and have investigated the prices used, finding them to be on the basis of cost or market, whichever was lower All known direct liabilities have been included, with the exception that provision has not been made for an assessment for Income and Excess Profits Taxes for prior years, the liability on which will be approximately $10,000

On the foregoing basis we certify that, in our opinion, the foregoing Balance Sheet presents the financial condition of the company as at Dec. 31, 1921

(Signed) MARWICK, MITCHELL & CO

SALES—$906,097 19 PROFITS—$644 52 after charging off $18,300 depreciation, all bad debts and marking merchandise inventories down to lower of cost or market

Paid Dividends on Preferred Stock of 6 per cent

BANK ACCOUNTS—Guaranty Trust Co , New York, N Y
National Newark & Essex Banking Co., Newark, N J
American National Bank, Newark, N J

Analysis B. J. H. Statement.—This shoe manufacturer does a business of $900,000 a year.

The ratio is $618,659 to $185,685 or 3.3 to 1. The liquid position is strong.

The cash—$13,356.68 would seem entirely too low for a concern of this size and the cash position is extremely weak. There may be a reason, which should be inquired into.

The notes receivable—$18,779.16 are normal.

The accounts receivable—$281,590 45 are about four months' sales. Shoes are sold on longer credit than generally obtains and this would not be out of proportion.

The investments are not heavy, both items being of high quality.

The inventory—$618,659 95 is certified to as being taken on a cost or market basis and may be accepted as stated. Such a manufacturer is not apt to become loaded with unsalable merchandise, orders being taken from samples. The retailer is more apt to be the sufferer. The danger is of returned merchandise; but until the retailer feels the pulse of his trade he cannot determine the salability of merchandise. This stock is not likely to go out of fashion while on the hands of the manufacturer.

Deferred charges—$19,805.14 have been commented on heretofore and need no repetition at this point.

Investments in shoe stores—$39,608 are undoubtedly investments in retailing establishments handling this line of shoes. Inquiry would probably show that the company is running retail stores of its own. If so, it makes both a manufacturing and a trading profit. The stock of these stores would not have a market value, although it might be valuable as controlling the retail end of the business.

The company has loaned $1,900 on security of some kind, not stated. It would likely prove an accommodation loan.

The real estate, machinery, office equipment, etc., and lasts are listed at their depreciated value—$253,845.03 The basis of this appraisal is not stated.

The concern has commercial paper amounting to $160,000 outstanding

The *accounts payable* are nominal $20,335.72.

Customers advances for merchandise and accrued wages, etc., are about $5,000 It is evident that the officers have left part of their salaries, or savings in the business, and others interested in the firm have loaned it money to the extent of $104,948.64, treated as a special deposit, and not listed as a quick liability.

The mortgage is small—$42,000.

Out of an authorized capital of $1,000,000 preferred and common, only $86,200 of preferred and $300,000 common has been issued.

The surplus is $214,974.11, or about 23 per cent of the total assets. The profits have been absorbed in depreciation of merchandise, charge offs, other depreciation, and the company has about "broken even" during the year under review. The company has paid dividends of but 6 per cent on the $86,200 preferred stock outstanding.

General Comment.—The liquid position is strong; the cash position weak. The results of operation have been unsatisfactory, but this was characteristic of 1921. The company is still strong in many ways and its paper would still be considered a safe banking risk.

Checking Letters

B J H. Company, New Jersey, inquired about Sept. 22, opened an account here January, 1919 Although we give them a line of $100,000 unsecured, they have never used more than $60,000, which amount is out now, and have cleaned up each year for several months.

The company manufactures a line of high grade shoes, which seems to meet with favor in the trade, enabling them to show sales of over $1,000,000 a year as a rule Their operations for 1921 were conducted at a profit, since most of the losses general in the shoe industry were taken by

the company in 1920. The plant located in New Jersey is considered one of the most modern in the State and is carried at a conservative valuation

Our acquaintance with and confidence in Mr B J H and Mr D encourage faith in the future prosperity of the company, in view of which we recommend the note as a desirable investment

Yours very truly,
Credit Manager

The B J H Company, of New Jersey, subject of your letter of Sept 22, has been valued customers of this bank for a number of years, and the relationship has been entirely satisfactory The business is under capable management

We have extended them a liberal line of credit accommodation, which is properly used At present they are out of debt

Our own good opinion is confirmed by depository banks, and in the trade the firm enjoys an excellent reputation Our experience with this account has been that a reasonable amount of its paper should constitute a satisfactory banking investment

Yours truly,
Cashier

Analysis B. Bros. Statement.[1]—This statement contains one of the romances of American business. In 1896 three practical cigar makers formed a co-partnership to manufacture cigars. They were brothers and had but a nominal capital. The earnings of the business were steadily reinvested in the business until 1912 when the investment amounted to $324,000. The business was then incorporated and the policy of returning the earnings back into the business was continued. Ninety-seven per cent of the earnings was so reinvested until 1919, the investment at that date having grown to $1,295,259.37. In 1920 three companies were merged and $1,000,000 of stock was sold, being the first outside money to be brought into the business. On Dec. 31, 1922, the investment had grown to $3,552,313.39 and the total assets $5,828,932.69. The sales grew from $3,981,000 in 1918 to $10,427,000 in 1922. The net earnings grew from $137,900 in 1918 to $1,123,900

[1] See page 746.

in 1922. During 1921, a period of general depression, this concern earned a larger profit than during any previous year of its history.

There are several exceptionally strong features about this statement. The ratio is 7.7 to 1, which is exceptionally large. This statement gives effect to the issue of $2,000,000 new stock and the retirement of $1,000,000 old first preferred stock which was converted into common stock and reduced to a par value of $234,900. The entire proceeds of the new stock was used for the retirement of the old stock, the reduction of current liabilities and the provision for new working capital made necessary by the rapidly increasing business.

The net sales were at the rate of approximately $900,000 a month. The accounts and notes receivable represent less than forty-five days' sales. Allowing a mark up as high as 50 per cent the cost of goods sold amounts to $600,000 a month. The accounts payable represent about fifteen days' purchases

The land and buildings are carried at $585,391.93, while the appraisal of an independent concern places the value of the fixed assets at a depreciated figure of $1,156,929.08. The plant is therefore carried at one-half its appraised value.

Analysis, Comparative Statement B. Bros.—The five-year comparative statement is interesting It shows steady and consistent growth in all items. The quick assets increase from $1,847,410 in 1918 to $5,084,599.14 in 1922. The ratio remains stationary except during 1922 when the new capital was introduced, which greatly increased this factor of safety. At the next audit the ultimate effect of the new money will become apparent

A review of the figures in the comparative statement is unnecessary, inasmuch as the reader may form his own conclusions by following the various items from 1918

to 1922. As a matter of fact this statement from every viewpoint is so admirable that it excites only wonder at the consistent progress made by these three brothers. The war, of course, gave the business a great impetus, but they were able to "keep their heads while other firms were losing theirs," (to paraphrase Kipling) and the result shows the wisdom of the management From nothing they have created a great business, which produced substantial profits from the beginning and which marks these men as of exceptional ability and foresight. The five year summary of profits and sales speaks for itself.

Years ended Dec 31	Net sales	Net profits before taxes	Net profits after taxes
1918	$ 3,981,460 99	$ 222,443 48	$ 137,975 29
1919	5,202,078 23	271,788 86	209,152.71
1920	9,654,922 83	524,573 37	364,249 92
1921	9,580,143 81	674,342 69	498,126 73
1922	10,427,177 25	1,284,486 79	1,123,925 94

CHAPTER XXIII

THE SAVINGS DEPARTMENT[1]

Evolution of the Savings Ledger.—The first savings bank in the United States used a journal into which were posted all transactions in the order in which they originated. From the journal they were posted into the various ledger accounts. These were bound books with numbered pages, only three columns being used, *i e* Date, Debit and Credit columns.

Periodically the debit and credit columns were totaled and the difference (balance) was entered in red ink. The columns were then ruled off and the balance carried forward. In order to determine the balance at any time other than at the time books were closed, it was necessary to total the debit and credit columns and then strike a balance. The only proof of postings obtained, was when the ledger was ruled off and a complete trial balance taken.

This was later improved by adding a balance column which provided a means of obtaining a proof of postings each day in the following manner: By entering on a scratcher or blotter the old and new balances at time account was posted and then totaling old and new balances, the difference between the two totals would equal the difference between the deposits and withdrawals.

[1] Otherwise called the "Interest Department," "Thrift Accounts," "Compound Interest Department," etc , in order to comply with the New York law, which limits the use of the word "savings" to savings banks and savings and loan associations By Courtesy Yawman and Erbe Mfg Co , Rochester, N Y

This met the disfavor of a great many bankers who thought it too burdensome to extend the balance after each posting.

The old bound ledger required a very intricate indexing system as the number of accounts grew, and much time was lost in locating accounts when posting. These ledgers were clumsy and hard to handle, required a great amount of space and were very expensive.

DATE NO			I hereby agree to be bound by conditions printed on reverse side
AMOUNT $			
AGE			RESIDENCE
'			
BIRTH PLACE			FATHER'S NAME
OCCUPATION			MOTHER'S NAME

FORM 57.—Signature card—savings department.

The next development was the loose-leaf system, the manufacturers of which had a hard time convincing bankers that they were practical and safe. But after a few years they were accepted as the last word in savings ledgers.

This type of ledger facilitated the handling and proving of accounts. As the bookkeeper made his postings, he inserted slips of paper next to leaf on which postings were made, and later these postings were proven by going through the same process as outlined when the bound ledger was used.

This system was greatly improved by the use of adding machines as they eliminated the blotter or scratcher.

The next and latest development was the card ledger which met with some opposition from the conservative type of banker, chiefly because he contended that a ledger card would be lost. But when asked if the bank ever lost five dollar bills he became highly indignant. He was told to consider each ledger card as he would a five dollar bill.

By the use of deposit and withdrawal tickets where the customer wrote his own ticket, which when sorted in order allowed the bookkeeper to make his postings without skipping back and forth in the ledger, there was a great saving of time and effort.

The ledger card today is being used by a great number of banks, particularly those of progressive type, it being adapted to either hand or mechanical posting.

The card ledger is applicable to any method of handling accounts and in any size or type of bank. The following are some of the methods used at present time and their advantages:

Plan or Method 1.—This method is used in banks where the number of accounts is small and one clerk can take care of the window work as well as the bookkeeping.

All cards are placed in or directly behind the cage. This can be arranged by use of vault truck which can also contain signature and index cards.

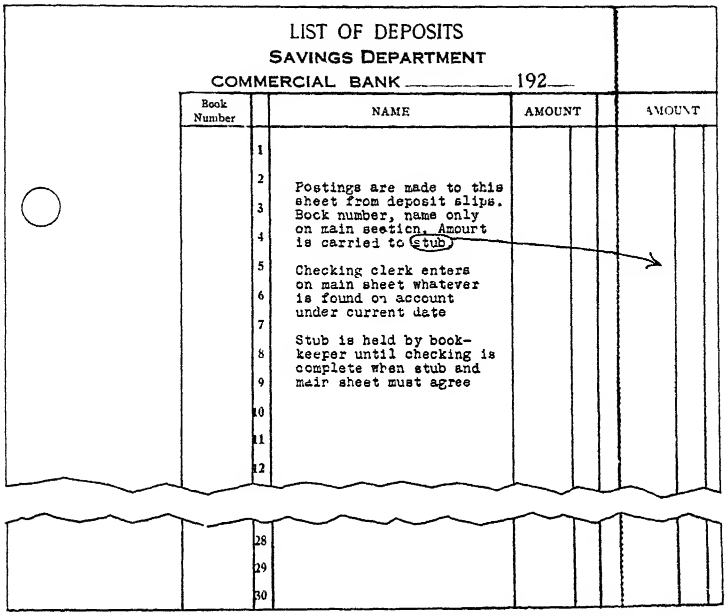
Deposits.—When a deposit is made, card is removed from file and replaced with "out guide." Deposit is then posted and card laid aside. (Posting can be made at close of day.)

Withdrawals.—Signature and pass book balance are compared with card which is removed from file and replaced by out guide. Posting is made and card laid aside. (Posting can be made at close of day.)

Daily Proof of Postings.—A run is made of deposit slips.

A run is made of withdrawal slips.

A run is made of *old* balances (balances on cards before current day's postings) on cards affected



Form 58—Savings department record of deposits—posting proof

A run is made of *new* balances (balances on cards after current day's postings).

The difference between the *old* and *new* balances must equal the difference between deposits and withdrawals

Comment.—This system, or any system where the teller has control of the ledger, is not advisable as it leaves the door open and invites manipulation of accounts

Where the one-man system is used, an officer or an audit committee of the Board of Directors should person-

ally take an independent trial balance, and should personally (or appoint a substitute) check pass books against the cards periodically.

Plan or Method 2.—This method is used where work is divided, *i.e.* tellers doing window work and bookkeepers handling ledgers.

Deposits.—Customers with few exceptions write their own deposit tickets. Teller proves deposit and enters it in pass book, noting new balance on deposit ticket. Deposit Tickets are entered on proof sheet by teller and then turned over to bookkeeper.

Withdrawals.—Customer writes own withdrawal slip. Teller compares pass book with ledger card or has a clerk or bookkeeper make the comparison. Teller then compares signature with signature card, deducts amount from pass book and makes payment to customer. Teller should also note amount of new balance on withdrawal slip. Withdrawal slip is then entered on proof sheet and turned over to bookkeeper.

Bookkeeper.—Bookkeeper makes a list of deposit and withdrawal tickets to see that amount received corresponds with amount with which he is charged. Tickets are then sorted into numerical order, cards pulled and out guides inserted in their stead, postings made and proof taken *i.e.*, old and new balances are run from cards affected. The difference between old and new balance should equal the difference between deposits and withdrawals.

Suggestions.—Under this system, the practice of inserting an out guide at time pass book is compared before withdrawal is made, has proven of great value

By having the bookkeeper run the amounts of new balances listed on deposit and withdrawal tickets, and comparing same with new balances run from cards, any errors existing between the pass book and ledger

card can be quickly detected. This will also prove that the proper card has been posted.

Plan or Method 3.—This method is used by banks which protect themselves with as many safeguards as possible.

Deposits.—Clerk at window makes out deposit ticket for customer and on a proof sheet or adding machine records number of account and amount of deposit.

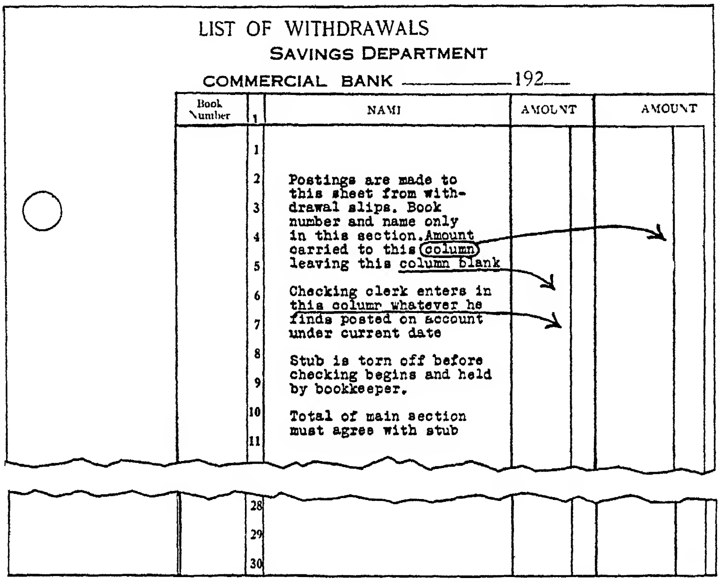
In account with COMMERCIAL BANK					
Date	Drafts	Deposits	√	Balance	

Form 59 —Savings ledger card

Pass book with monies and deposit ticket are then passed on to receiving teller who proves the deposit and enters same in pass book also noting amount of new balance on deposit ticket. Deposit tickets are passed on to bookkeeper after being entered on teller's proof. At close of the day the receipts of receiving teller must equal amount recorded by first clerk.

Withdrawals.—Clerk at window makes out withdrawal ticket which customer signs. He then compares pass book with ledger card or turns it over to bookkeeper for comparison and O. K. of withdrawal ticket. He then

records number of account and amount withdrawn and passes withdrawal ticket and pass book to paying teller who compares the signature, makes deduction from pass book and pays customer, also noting amount of new balance on withdrawal ticket. After teller enters slips on proof sheet they are passed on to bookkeeper.


LIST OF WITHDRAWALS
SAVINGS DEPARTMENT
COMMERCIAL BANK ________192__

Book Number	1	NAME	AMOUNT	AMOUNT
	1			
	2	Postings are made to this sheet from withdrawal slips. Book number and name only in this section. Amount carried to this column leaving this column blank		
	3			
	4			
	5			
	6	Checking clerk enters in this column whatever he finds posted on account under current date		
	7			
	8	Stub is torn off before checking begins and held by bookkeeper.		
	9			
	10	Total of main section must agree with stub		
	11			
	28			
	29			
	30			

FORM 60.—Savings department record of withdrawals

Total of all payments made by paying teller must equal total recorded by first clerk.

Bookkeepers.—Method of bookkeepers is same as described in Plan 2.

Comment.—It can readily be seen that under this system it is almost impossible for teller to default.

Mechanical Posting.—Practically all posting machines now manufactured combine the posting and proving in the same operation.

For additional check as to proper posting, a good many systems have been devised by these manufacturers, such as creating a predetermined total of old balances, accumulating account numbers and clearing machines by deducting pass book balances.

Advantages of the Card System.—The advantages of the card ledger are so well understood that most banks which still use the loose-leaf ledger are merely waiting an opportunity to change.

Conservation of Space.—The card ledger conserves space because it is compact. Closed accounts are easily eliminated thereby reducing the number of accounts to be handled. Ledger may be placed in or directly behind cages so that no time is lost in comparing pass books. This enables teller to give the maximum of service to customers.

One tray or drawer will retain cards equivalent to three binders and in the space of one binder.

Accessibility.—The card ledger is accessible to one or more persons at the same time. The bookkeeper can remove all cards that are to be posted from file leaving the remainder of cards available to teller and other clerks. This proves valuable at interest and audit periods. It eliminates handling binders to and from shelves.

Efficiency.—The removal of cards from file for posting purposes greatly increases the efficiency of the bookkeeper as it allows him to concentrate on his work without being disturbed by others. It also facilitates the proving of balances as all affected cards are at hand

Cards provide a flat writing surface at all times, which is more desirable than the curved surface of a book ledger.

Signature Line.—The signature on ledger card combines two operations in one, *i.e.* pass book balance and

signature can be verified at the same time. By having the signature on ledger card, the loss of a signature card is diminished in importance. By taking a new signature when ledger card is filled signatures are kept current.

Interest Column.—A great many banks still use a book or sheets on which they compute their interest. From the book or sheets the interest is transcribed to the ledger at the interest period. This involves a great amount of labor and usually a great many errors result. By using the interest column provided on the card, a great many errors and a large amount of labor is eliminated.

Reversible Shoulder Tabs.—Savings ledger cards are furnished with reversible shoulder tabs. When the face of card becomes filled, the reverse side is then turned to the front which places the current balance before the clerk at all times.

The numbers on the tabs represent the last digit of the account number, bring all cards tabbed –0– in the first position and all tabbed –1– in the second position, etc., and make all cards visible. This reduces appreciably the time spent in finding an account and also serves as a check against mis-filing.

Tinting.—Cards can be furnished with tabs tinted in a large assortment of colors. If each lot of 1,000 cards is tinted a separate color, any card mis-filed will be plainly visible.

This tinting feature is often used to distinguish between sections, blocks or controls into which the accounts are divided.

Out Guides.—The use of out guides in connection with the savings card ledger makes the system extremely flexible. In case of withdrawal or deposit the card may be pulled to be laid aside for posting later, and an out guide inserted. When ledger card is returned to its place, out guide is withdrawn which automatically

acts as a check against loss or mis-filing, as the presence of an out guide in the file at the end of day would immediately call attention to card missing or out of place.

Stop Payment.—Stop payments are a nightmare to the average bookkeeper using a loose-leaf or bound ledger With the card ledger this is simplified by using a stop payment jacket of distinctive color.

Indexing Arrangement.—By using sets of 10–90 guides with reversible shoulder tabbed cards, each and every account is visible, and only the card wanted is handled.

When any part of the file becomes over-indexed because a number of accounts are closed, guides not needed are used to index cards in closed file.

CHAPTER XXIV

ACCEPTANCES

Bank Credit.—A bank is commonly spoken of as a manufactory of credit, and this is true, for the major part of its activities are operations in credit The various forms of bank credit are created:

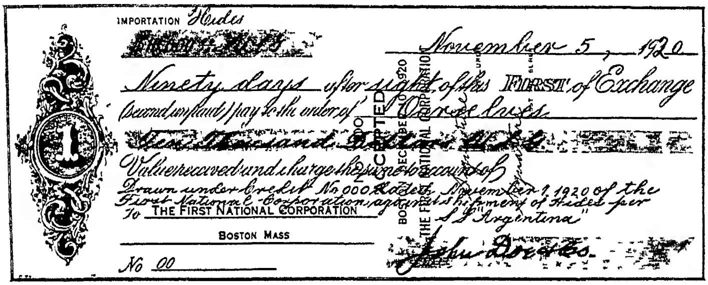
1. *By Accepting Deposits.*—In receiving a deposit the bank simultaneously gives the depositor the right to draw checks. These checks are credit instruments. In many respects they supplant money. They pass from hand to hand as money, and to a very large extent take the place of money in all but the small exchanges The great majority of persons look upon a bank check, not as an order on a bank, but as so much money; and especially so if they know the maker of the check. Therefore the great mass of bank deposits become a *circulating form of credit* that is very widely used by millions of bank depositors.

2. *By Certifying Checks.*—When a bank certifies a check, it passes upon the credit of the maker of the check and pronounces it good. It certifies to his credit and guarantees to meet the obligation he has created. It takes a less known credit and makes it well-known. It makes the credit its own, and guarantees to redeem it upon demand.

3. *By Issuing Bank Notes.*—The issue of bank notes constitutes one of the oldest and most common forms of bank credit. Bank notes are simply promises of the bank to pay. They may be secured or unsecured,

but they pass current because of the fact that they are considered as money by the public. They are not money, but are its perfect substitute and are in use the world over; and as has already been observed in this work, the right to issue such money differentiates a bank from all other institutions.

4. *By Making Loans.*—The process of creating deposits out of loans has already been treated at length and need not be repeated here. As soon as a bank credits the proceeds of a loan to a borrower's account, it gives him the right to put his checks into circulation. Having


IMPORTATION Hides

November 5, 1920

Ninety days after sight of this FIRST of Exchange (second unpaid) pay to the order of

Value received and charge the same to account of

Drawn under Credit No 000 dated November 1, 1920 of the First National Corporation against shipment of Hides per S S "Argentina"

To THE FIRST NATIONAL CORPORATION

BOSTON MASS

No 00

ACCEPTED

THE FIRST NATIONAL CORPORATION

John Doe

FORM 61 —Acceptance covering import transaction

accepted this credit running to itself, it permits the borrower to draw against the credit in favor of others In the final analysis the bank guarantees to the holders of such checks that the borrower will meet his notes held by itself; for if he does not, the bank has created a credit which did not liquidate itself and it must take a loss. The borrower could not place his own promissory notes in circulation, for the public does not know him as a credit risk, or the quality of his notes, and these would not be acceptable in trade. The public does, however, have confidence in him as a maker of checks, and will accept his checks payable on demand, drawn against a credit payable at some future time, the nature of which is unknown to the holder of the check. The

holder is satisfied to know that the bank will, in all probability, honor the checks received by him from others. The basis for their issue does not concern him

The bank in its check operations creates a form of circulating currency that has all the usefulness of money, with none of its costs or dangers. The bank, in crediting a loan to the borrower's account, agrees to honor his checks drawn against the credit. If the credit turns out to be insecure, the bank nevertheless has guaranteed it and the loss falls upon itself for creating what has turned out to be an unwarranted credit. The effect of this is no different from the bank paying a borrower in the form of bank notes, except that in the case of notes the bank creates what is essentially money, and in the case of checks it creates a *form* of money. The bank, in its note issues, agrees to redeem the notes in lawful money; and in the case of loan credits, it also agrees to redeem in money the checks drawn against the credits. Broadly considered there is but little to distinguish the two in the ordinary affairs of business life.

5. *By Making Acceptances.*—When a bank accepts an instrument, it stamps upon it its agreement to pay the same according to its tenor. This agreement is not expressed, but implied. No special form is necessary, and no exact words are required. The contract to pay is the same whether the acceptor specifically states that it will pay the instrument, or merely writes its name across the face.

In making an acceptance, the bank assumes and agrees to pay the same, and this promise is as strong as the acceptor. The promise to pay (made by turning an order into a promise) is secured by its entire assets, the same as in its note issues. Therefore, a bank acceptance may be said to be on a par with a bank note, in that it is the unequivocal promise of the bank to pay,

and in this sense bank credit rises to its highest level. The only difference between a bank note and a bank acceptance, insofar as the security goes, lies in the fact that some bank notes are secured by specific collateral, in addition to the general worth of the issuer, while acceptances are secured, by implication, by the entire assets of the accepting institution.

Bank credit may therefore be said to consist of the creation, the issue and the redemption of such instruments as represent a *credit in the bank* or an *obligation by the bank*

Prior to 1914 the trade acceptance was practically unknown in American business circles. The significance of this instrument was not apparent to our business men, and its meaning and its uses were utterly strange to most merchants and manufacturers. The common method of financing business was by the book account, commonly called the "receivable." The seller borrowed from his banks and in the open market in order to carry the buyers during the credit period, and the buyer in turn borrowed to carry his customers, and so on until the goods reached the ultimate consumer. Even the retailer who was not well fortified with capital found it necessary to borrow in order to carry his charge accounts. The idea of obtaining an instrument from the buyer that could be passed into banking circles on its merits was never thought of until the Federal Reserve Act brought such instruments prominently before the business public.

Such an instrument easily lends itself to the most desirable uses, and at the same time it may be prostituted to a use never intended for it and utterly dangerous If, for instance, a firm in New York sells a bill of goods to a firm in Albany and takes in payment a trade acceptance which represents a bona fide transaction, it may immediately sell this instrument to its bank. The bank may

in turn rediscount it at the Federal reserve bank. The latter may use it as the basis of Federal reserve notes. When the credit period is ended and the buyer has turned his goods into money, it will automatically pay itself. It is born out of a business transaction and dies when the transaction is finally consummated through the ultimate consumer. The burden of carrying the credit rests upon the banking institutions which are peculiarly adapted to carry such credits, and are specially created for this purpose. The merchant and the manufacturer deal in merchandise. That is their primary function. The bank deals in credit. The two interests harmonize perfectly. Neither should encroach upon the rightful prerogatives of the other. Each is a specialist in his field.

But if the so-called acceptance arises out of a purely fictitious transaction, with no sale of goods to bring it into existence, it is a fraud upon all who handle it in good faith. If no value has passed between buyer and seller, there can be no self-liquidation. It is the raising of money by a fraud. Someone must pay it, if at all, out of his general resources and there has been put into circulation a pure accommodation note.

Take, for example, this instance: A coal operator in New York sells coal from his mine to a coal company in Cleveland—at least he pretends to do so. He may sell a limited quantity and so establishes the connection. He receives acceptances in payment. He finds that his coal acceptances are acceptable to his banks. They are always paid at maturity. He gets into financial difficulties, and arranges with the Cleveland firm to draw on them by trade acceptances which they agree to accept as a matter of friendship. He issues large numbers of these instruments and finds a market for them among banks which are willing to deal with him. As a matter

of fact these acceptances are filled out in blank in his office in New York and accepted when created by the Cleveland firm. As he needs funds he has them filled in and discounted. As the acceptances fall due he telegraphs the funds to Cleveland to meet them. In reality he takes up one acceptance with the proceeds of another. He always has a batch of these acceptances ready for emergencies. If he were called upon to substantiate their regularity by invoices of shipments he could not do so. He might and doubtless would show an entered order, to make them appear bona fide. On their face they appear regular; in reality they are fraudulent instruments. No value has passed and none was ever intended to pass. They can never in the course of business liquidate themselves.

Disadvantages of the Account Receivable.—When the Federal Reserve Act legislated the trade acceptance into our business and banking structure, it was hailed with acclaim by the banks, business houses and chambers of commerce throughout the country. The book account, distinctive to American credit practice, was conceded to have certain disadvantages which were to be overcome. Briefly stated these are:

(*a*) The seller must carry the buyer on his books during the period of the credit. He must be strong enough in his own right, or in borrowing facilities, to do this.

(*b*) The term of the credit is more or less elastic. While the credit term is agreed upon between buyer and seller, a lapse of a few days or even weeks or months is no uncommon occurrence. And to get prompt payment, discounts are allowed as a reward for promptness. These discounts are of necessity added to the cost of the goods.

(*c*) The book account does not form a proper banking collateral. The merchant who must pledge his accounts

receivable, pledges his most liquid asset next to cash, and the banking world does not favor such a practice. And if it is done, as now obtains very largely, it must be through the medium of discount companies that exact a high toll for the risks involved.

(*d*) Where it becomes necessary to collect through the courts, the action is for goods sold and delivered, with all the defenses applicable to such transactions.

(*e*) Buyers are tempted to overbuy because of the nature of the credit extended.

(*f*) Goods are easily returned.

(*g*) The buyer is tempted to extend credit too freely to his customers, making the credit structure weak throughout.

Advantages of the Trade Acceptance.—The trade acceptance was eagerly adopted as a panacea for all the evils of the open book credit, for it (*a*) Places in the hands of the seller an instrument that his bank will freely discount, thus placing the burden of carrying the credit upon the bank, where it belongs.

(*b*) The buyer has a definite engagement to meet, and the seller has definite maturities to his credits Therefore the seller receives payment promptly, and the buyer makes his payments promptly, thus benefitting both.

(*c*) Having definite engagements to meet, or suffer his paper to go to protest, the buyer will buy cautiously and extend credit wisely, an obvious advantage to him.

(*d*) The seller holds a self-proving instrument in a court of law, and can sue upon a negotiable instrument, rather than on a bargain and sale of goods.

(*e*) The book accounts of the seller become "notes receivable," making the credit in better form and reducing his merchandise to a higher type of bankable instrument.

(*f*) Being in favor with the Federal reserve banks as to discount privileges, the interest charges for credit are less even than for commercial paper and far less than in the pledge of accounts receivable, even under the most favorable terms.

With these decided advantages in favor of the trade acceptance, propaganda was spread far and wide by banks and business houses, advocating their adoption. The business men were quick to see these advantages and acted accordingly.

In the open account method of selling disputes as to quality, warranties, etc., may arise. Difficulties in a suit are many, since delivery, terms, conditions, representations, etc., may have to be proven. In the acceptance method, as elsewhere discussed, the obligation is absolute, under the rule that if the buyer does not intend to pay, he should not make the acceptance The buyer has admitted his debt. In the hands of an innocent purchaser for value it is quite unassailable.

The open account is costly. It requires bookkeeping, follow-up systems, dunning letters, statements, and legal processes in case of default. In an acceptance, suit is brought upon a negotiable instrument. The procedure is simple. In the book account suit is brought upon goods sold and delivered. The procedure may be slow and complicated.

Once the acceptance is executed the problem of returned goods, cancelled orders, etc , is eliminated. This is an ever present danger in open account selling.

The buyer suffers no hardship in making an acceptance He obtains his credit for a definite time. He knows the time exactly. He will therefore buy cautiously, extend wisely and collect promptly. The seller may discount the acceptance at his bank and have immediate use of the funds. To carry the credits arising from business

is the function of the bank; to sell merchandise is the function of the merchant. In the book account system the seller becomes both a trader and a banker.

In selling or hypothecating the open account the seller impairs the value of his statement by such a process to the extent that banks ares keptical of firms resorting to this expensive method of borrowing. Such a process is costly in money and credit.

To the seller the trade acceptance releases funds tied up in book accounts and gives him cash for his sales. He may know with reasonable certainty what his maturities will be, while he can only approximate his receipts from book accounts. The buyer, on the other hand, will be loath to allow his paper to go to protest with the attendant loss of credit in his bank and with his principal.

The seller may freely discount such acceptance paper, inasmuch as he is expected to do so, and the legal limitation as to bank loans does not apply to two-name paper taken in the course of business.

Two-Name Paper.—As an alternative to selling on open book credit and borrowing in the form of commercial paper, the seller may take the promissory note of the buyer payable at such time as may be agreed upon. The maturity of the paper is generally long enough to allow a resale of the goods by the buyer. The seller may take such instruments to the bank and discount them for his own account. Many banks allow their customers a stated line of credit upon such paper, and as a rule of law, such loans are not considered as money borrowed and do not come under the restrictions applicable to loans to customers. Where the discounter is in good credit, the bank may accept all paper offered without checking; but where the customer is of limited resources

the bank may make inquiry on each piece of paper offered. This is usually done through the banks, particularly the bank at which the paper is made payable. After handling the paper of a concern for a time, it will be found that notes of the same firms are presented from time to time, so that the banker becomes familiar with the names offered by his own customer. These are rechecked from time to time, but care should be taken that renewals are not disguised as new paper. Each note is presumed to represent a separate transaction, and if dates and amounts show any signs of coincidence, inquiry should be made to ascertain their regularity Paper of this kind is called "two-name paper."

Two-name paper differs in no essential from acceptances, an acceptance becoming in legal effect a promissory note when accepted by the drawee. A few lines of merchandising have been characterized by two-name paper for many years past, but these have been in the minority, the great majority of merchants and manufacturers having operated under the book account credit as a matter of custom. As the advantages of two-name paper, whether in the form of an acceptance or straight two-name paper, have become manifest, the movement toward the latter practice has gained great momentum during the past few years. The propaganda has had its effect and the time is fast approaching when the acceptance will occupy the same place heretofore accorded the book account in our selling methods.

Acceptances, How Made.—A trade acceptance may be defined in short as "a bill of exchange accepted by a tradesman." More specifically, it is "an unconditional order in writing signed by the maker, directing a designated third party to pay to a designated second party or bearer, a sum certain in money, on demand or at a specified future time, which has been accepted by the

drawee." The effect of acceptance is to turn an order *on* the drawee into a promise *by* the drawee. This acceptance may be accomplished by the drawee writing his name across the face of the bill under the word "accepted," although the mere writing of the name is sufficient. Trade acceptances as now used have a clause to the effect that "The obligation of the acceptor arises out of a sale of goods by the maker to the acceptor." In making acceptances it is customary to date the instrument and name a place of payment, usually a bank. This does not, however, make it a bank acceptance, which must bear the acceptance of a bank.

Bank Acceptances.—In considering the subject of bank acceptances, we must bear in mind two principles of banking, to wit: (*a*) That a bank may assist in financing business transactions by a loan of funds, either in the form of cash or a credit on its books, which may be drawn against. The credit may arise from a loan or a discount (*b*) It may *lend its credit* by guaranteeing to pay the obligation which is in the first instance created by another. In this process it loans its credit by accepting drafts or bills of exchange drawn on itself or one of its clients, thereby making them *bankers' acceptances*.

The acceptance is one of the oldest forms of credit instruments, and has been the predominant method by which the merchants and banks of European countries have carried on their operations, particularly in regard to foreign trade. It has long been the practice in such countries for merchants to pay for goods purchased by accepting a draft drawn by the seller upon the buyer, payable at a future date. After establishing themselves as sound and capable of meeting their obligations, it became a natural sequence to accept on behalf of others, for a consideration. Where the acceptance was made

by the acceptor for his own account, it would correspond today to our trade acceptance; and when made for the account of another, it would correspond to our banker's acceptance

Growth of Trade Acceptances.—The American Acceptance Council is authority for the statement that in 1916 the known users of trade acceptances numbered 185. In October, 1920, there were more than 20,000 firms using this form of paper, embracing every line of business that makes sales on a time basis.

Moreover it has accomplished what it set out to do, namely:

(*a*) It has shortened the credit period.

(*b*) It has made collections more certain

(*c*) It has enabled an equal amount of capital to do a greater amount of service.

(*d*) It has eliminated many troublesome claims and disputes.

(*e*) It has reduced the expense of operation both for buyer and seller.

(*f*) It has stabilized business and produced a character of strictly liquid paper.[1]

Abuse of Trade Acceptances.—In a general survey of the trade acceptance, from the standpoint of its weaknesses, in the December, 1921, number of the *Burroughs Clearing House*, James H. Collins sums up the abuse of these instruments as follows:

1. *Renewals.*—It has been found that acceptances have been renewed from time to time, often in such amounts as to deceive the banker into believing them to be current paper. This practice, of course, destroys the essence of the instrument, which is presumed to be born with a sale of goods and to pass out of existence when the credit

[1] American Business and Acceptance Journal for December, 1921

term is over. The life of an acceptance should be long enough to allow the buyer to re-sell the articles, or to turn the raw material into finished products. Renewed acceptance paper represents merely an overdue account, which it was designed to prevent.

2. *Overdue Accounts.*—It has been found that merchants have been drawing and accepting such instruments for accounts that were overdue. Such paper is obviously false in its representations and is nothing but a promissory note given for a past due debt.

3. *Capital Purchases.*—Trade acceptances have been found to have been given for machinery and fixtures, etc., which represent capital investment. Such purchases are not self-liquidating and it was never intended in law or in business practice that the acceptance should represent a capital investment, which should be financed by stock and bond issues, mortgages and such forms of long-time loans as are recognized as proper for such purposes

4. *Acceptances Given for Services.*—In other cases they are promissory notes given for wages, salaries and commissions—which never was the intention in introducing these instruments into our commercial structure.

The giving of preferential rates of discount on acceptance has no doubt been instrumental in making these instruments popular with the business man. He is keen to take advantage of a fractional rate in his favor and while his acumen is commendable, the methods by which he expresses his keenness are to be deplored

The gravest evil, however, lies in kited acceptances, which are even worse than kited checks. It was the writer's privilege during the latter part of 1921 to round up the evidence from documentary sources that uncovered a far-reaching and highly complicated system of kiting by the use of acceptances. The amount involved in this operation was over a quarter million dollars

Three firms floated in the course of two years no less than half a million of fictitious paper, which was discounted at various banks and commercial bankers, and, in fact, wherever they could place them.

The acceptance is one of two things: It is either the premier instrument of banking and business, or it is a monumental fake. It either represents a legitimate bargain and sale of goods, or a rank imposition upon the banking world. But in speaking of the acceptance, we must differentiate between the bank acceptance and the trade acceptance. It is safe to assume that no bank would lend its credit to an acceptance that did not arise out of a merchandise transaction. The exhibition of the accompanying documents must be a condition of the acceptance. The danger lies solely with the trade acceptance that arises in the business world and then passes into the banking world, first as a bank asset and then as the foundation of our currency system.

In a period of prosperity the business man does not have to resort to treacherous methods to keep his business afloat. He can navigate his ship in a calm sea. But in a period of falling prices and depression, he faces the danger zones, and seeks to avoid them by fraud and chicanery It is in such a period that kited checks are used and fictitious acceptances created—not necessarily with the intent to defraud, but with the hope of bridging the time of stress.

It has been claimed that inasmuch as the trade acceptance bears on its face notation that the instrument represents a transaction in merchandise, it is incumbent on the banker to ascertain the regularity of the transaction, or assume the risk of the paper being improper. In other words, the banker must either verify the origin of the paper or accept the risk that failure to do so involves.

If the banker is charged with the duty of appraising the goods and ascertaining the nature and regularity of the transaction, the trade acceptance will be weighted down with a surplus of baggage that will ultimately make it an outcast in the banking world

It would seem to be desirable to have the date of the invoice inserted in the acceptance, although this might involve points of law that would make it unsafe to do so. It has been well said that a negotiable instrument should be a "carrier without luggage," and any reference to other documents or instruments might negative the value of such a clause.

Insofar as possible the instrument should be complete in itself and all surplusage avoided; but at the same time the banker will eventually insist that he be assured that the instrument is what it purports to be. As an alternative he will prefer to do business under the former methods rather than take the chance of kited and fictitious acceptances.

There is, however, one simple safeguard. The banker can easily make such a test as comparing the business of the maker and acceptor, and if the two are handling lines of merchandise that do not dovetail together, close inquiry should be instituted as to the purpose of the paper. Proper instruments cannot arise from lines that do not harmonize in their relationships.

The courts have yet to state what specific crime is committed when a worthless trade acceptance is passed into a bank's assets. The penal law of New York provides. "A person who, with the intent to deprive or defraud the true owner of his property, or the use and benefit thereof, or to appropriate the same to the use of the taker, or of any other person; takes from the possession of the true owner or of any other person; or obtains from such possession by color or aid of fraudulent or

false representation or pretense, or of any false token or writing steals such property, and is guilty of larceny."[1]

The interpretation of the above would seem to be, that if the holder of a trade acceptance, which on its face claims to have arisen from a merchandise transaction, takes the instrument in good faith and on this presumption, and it turns out to be fraudulent, the money has been obtained under false pretenses, which would make the transaction actionable under the penal law of New York.

When the framers of the Federal Reserve Act made the basis of the Federal Reserve Notes 40 per cent gold and 100 per cent eligible paper, they intended this foundation to be self-liquidating It was the obvious intent that Federal Reserve notes should come into being through the demand of the business world as evidenced by paper discounted, and when the demand was satisfied, the notes would automatically be retired by the payment of the obligations back of them. In other words, value in the form of goods sold and delivered was to be the basis of our currency system. But what shall be said of a currency system that is based upon kited paper? And how much of such paper is now in the Federal system, no one would even hazard a guess.

If four firms in the course of a few years can inject a quarter of a million false paper into our banking system, what limit shall be placed upon the possibilities of such paper when 20,000 firms are conceded to be using them?

There is an obvious need for remedial legislation that will adequately define the crime of issuing such paper, with severe penalties that will rank with the penalty of counterfeiting. This will have to be done by the various states reading into their penal law exact

[1] Sec 1290

language covering such practices, with suitable penalties for the transgressor. Otherwise we have with us the most dangerous instrument that has yet been created to defraud. Its beauty has been badly scarred by misuse, which, while it cannot be prevented, should be adequately punished.[1]

Definition of Banker's Acceptance.—A bank acceptance is "a bill of exchange or draft, payable at a fixed or determinable future time, upon the face of which has been executed in writing the unconditional promise of a bank or banker or corporation dealing in acceptances, to pay the same according to its tenor." This obligation is incurred by simply writing or stamping the name of the bank with or without the word "accepted" across the face, with the date of acceptance and signed by an officer of the bank.

Security for Acceptances.—The security to the holder of a bank acceptance is the same as in a certified or cashier's check. It is the unconditional promise of the bank to pay the amount, and is ultimately secured by the accepting bank's entire resources. There is, in addition, the secondary obligation of the drawer and indorsers if any thereon. Unless the acceptance is drawn for the purpose of creating dollar exchange (drafts payable in dollars) it has back of it a commercial transaction, and is supported by the customer's agreement with the bank to place the bank in funds in advance of its maturity, and by a pledge of goods involved in the transaction.

Inasmuch as the sale of the goods is presumed to provide funds for the payment of the acceptance, it may in this sense be said to be self liquidating. The holder, however, does not depend upon the sale of the

[1] From an article "The Menace of the Kited Acceptance" in the April, 1922, *Burrough's Clearing House* by the author

goods to secure payment, since he has the absolute obligation of the bank to pay. The bank may, however, have payment to itself held up by delayed sale of the goods, but this is part of its risk as acceptor, and for which risk it exacts its fee. Bank acceptances are exceedingly liquid, inasmuch as there is now a broad and steady market for them among commercial banks, savings banks, insurance companies and in some instances such institutions as colleges, hospitals and the like. They are now offered by discount and acceptance houses and banks, over the signatures of some of the largest and best known banks in the country. They come in all denominations and mature as a rule within ninety days and may be had maturing at any time desired. They are salable in the open market through the discount and acceptance houses above mentioned, and are bought in the open market by Federal reserve banks for their own account. The rate for such paper is generally the lowest quoted in the money market. They may also be readily rediscounted at the Federal reserve banks.

Many bank acceptances are not drawn directly upon a bank or banker, but are trade acceptances which are accepted by a bank or banker for the benefit of the drawee The purchaser of merchandise may enter into an agreement with his bank that it will accept certain bills for his account. The bank does not become a party to the instrument except as a place of payment, until it has been accepted by the bank. Moreover the agreement to accept does not become operative in favor of the public until the acceptance has actually taken place.

Authority to Make Acceptances.—The National Bank Act granted no authority to banks to make acceptances. A few of the larger trust companies had such powers but they were not as a rule recognized as part of our

banking customs. The Federal Reserve Act specifically authorized member banks to make acceptances growing out of:

1. The importation or exportation of goods.
2. The domestic shipment of goods.
3. The storage of readily marketable staple goods.
4. The creation of dollar exchange.

Many of the state laws were amended giving state banks and trust companies the same powers.

The Federal Reserve Act permits

> any member bank to accept drafts or bills of exchange drawn upon it having not more than six months' sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods, or which grow out of transactions involving the domestic shipment of goods, provided shipping documents conveying or securing title are attached at the time of acceptance, or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples

Limit of Acceptances.—No member bank shall accept, whether in a foreign or a domestic transaction, for any one person, company, firm or corporation, to an amount exceeding at any time in the aggregate more than ten per cent of its paid-up and unimpaired capital and surplus, unless the bank is secured either by attached documents, or by some other security growing out of the same transaction as the acceptance.

No bank shall accept such bills to an amount exceeding in the aggregate more than one-half its paid-up and unimpaired capital and surplus; provided, that the Federal Reserve Board may, under regulations prescribed by it, which shall apply to all banks alike regardless of the amount of capital and surplus, authorize any member bank to accept such bills to an amount not to exceed

at any one time in the aggregate, 100 per cent of its capital and surplus, and

Provided further, that the amount of acceptances growing out of domestic transactions shall in the aggregate in no event exceed one-half its capital and surplus.

Dollar Exchange.—Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations established by the Federal Reserve Board, by banks or bankers in foreign countries or dependencies or insular possessions of the United States, for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies or insular possessions, provided,

That no member shall accept such drafts or bills of exchange referred to above for any one bank to an amount exceeding in the aggregate ten per cent of the capital and surplus of the accepting bank unless the draft or bill is accompanied by documents conveying or securing title to goods or by some other adequate security; and provided, further,

That no bank shall accept such drafts or bills in an amount exceeding in the aggregate at any one time, one-half the paid up and unimpaired capital and surplus.

The Acceptance Market.—Discount corporations or acceptance houses have been formed in all the leading financial centers. These houses not only make acceptances but more especially make a market for the acceptances made by the banks for their customers They are essentially brokers, buying acceptances from banks and selling them to other banks and institutions desiring short time and exceedingly liquid investments. The acceptance or discount market may be said to center in and around these institutions.

Operation of a Bank Acceptance.[1]—An American importer has purchased a shipment of hides in Buenos Aires. The foreign shipper is unwilling to rely on the credit of his customer for payment; but the importer has the confidence of his own bank in the United States.

The latter, therefore, at his request, opens a letter of credit in favor of the foreign shipper, authorizing him to draw on itself up to a certain maximum amount against shipment of the hides, and agreeing that it will accept all drafts that comp'y with its terms. By a separate agreement the importer undertakes to place the bank in funds in advance of the maturity of its acceptance and otherwise to protect its interest throughout the course of the transaction.

The beneficiary is notified, usually by cable, of the terms of the credit He thereupon arranges for the shipment, draws his drafts and sells them, accompanied by documents securing title to the shipment, at the prevailing rate for dollar drafts in his own market, thus receiving immediate cash payment for his hides, in Argentine pesos. Or, if he is not in need of funds at the time he may have the drafts forwarded for acceptance and held for investment and collection at maturity for his account.

In the meantime the hides have arrived in this country and are, perhaps, sold in advance of their arrival. Title to them is in the hands of the accepting bank through its receipt of the relative documents. If the importer's credit is of the highest rating, he may obtain the documents against a trust receipt Otherwise, he will be required to give acceptable collateral or make partial or full payment. In either case, he secures possession of the hides and is prepared to deliver them to

[1] Pamphlet issued by the First National Corporation of Boston, an acceptance corporation

his customer, and, with their proceeds, place the bank in funds to meet its maturing acceptance upon presentation.

Exportation.—Export transactions, financed in the United States, involve a different set of conditions from those pertaining to imports, inasmuch as the purchaser of the goods is not ordinarily well known in this country, and his credit risk must be covered by suitable guaranties. The American exporter usually wishes to avoid the uncertainties of foreign exchange, so that he may know in advance the exact proceeds of the sale of his goods in American money. He therefore requests his customer to arrange for the opening of a dollar credit in his favor through the latter's bank abroad. This procedure is, in effect, a guaranty of the purchaser's credit, since the accepting bank here looks to the foreign banker, at whose request the credit was opened, for the discharge of the resulting acceptance liabilities.

The details of the credit having been agreed upon, the exporter is advised of its terms, and proceeds to arrange for the shipment of the goods. He then draws his drafts on the American bank, and presents them, accompanied by the shipping documents, for acceptance. All of the papers being in order, the drafts are accepted and returned to the drawer to be held by him or disposed of in the market, as his needs may require. The American bank then notifies the foreign bank of the amount of its acceptance and commission, and the date upon which it should be placed in funds, at the same time forwarding to it the relative documents securing title to the shipment. In the ordinary course the goods will arrive and be paid for by the purchaser to the foreign bank, and remittance will reach the hands of the accepting bank in time to cover its acceptance at maturity.

Domestic Shipment.—The domestic shipment of goods may be financed through the use of bank acceptances,

provided, in every case, "shipping documents conveying security title are attached at the time of acceptance."

Full particulars of this credit have been cabled to
The First National Bank of Boston, Buenos Aires, A R.

No 000 LETTER OF CREDIT NOT EXCEEDING $100,000 U.S.G

THE FIRST NATIONAL CORPORATION
BOSTON, U S A

November 1, 1920

Messrs. John Doe & Co.,
Buenos Aires, A.R.

DEAR SIRS:-

WE HEREBY AUTHORIZE YOU TO DRAW ON
The First National Corporation
Boston, U.S A.
AT Ninety days SIGHT FOR ANY SUM OR SUMS NOT EXCEEDING IN TOTAL
One hundred thousand dollars, U.S.G.

FOR ACCOUNT OF Messrs. Richard Roe & Co., Chicago, Illinois
FOR INVOICE COST OF Wet salted steer hides

FREIGHT INSURANCE including war risk effected here
TO BE SHIPPED FROM Buenos Aires TO Boston, C & F

BILLS OF LADING FOR SUCH SHIPMENTS MUST BE MADE TO THE ORDER OF
The First National Corporation
Boston, U.S A.
AND TOGETHER WITH THE INVOICES MUST ACCOMPANY THE DRAFTS

A DUPLICATE OF SUCH INVOICES WITH CONSULAR CERTIFICATE ATTACHED TOGETHER WITH ONE COPY OF BILLS OF LADING AND INSURANCE CERTIFICATES WHERE REQUIRED MUST BE SENT BY THE BANK OR BANKERS NEGOTIATING DRAFTS DIRECT TO
The First National Corporation
Boston, U.S.A.
BY FIRST MAIL ATTACHING TO THE DRAFT A STATEMENT THAT SUCH DOCUMENTS HAVE BEEN SO FORWARDED

BILLS OF LADING MUST BE DATED ON OR BEFORE May 1st, 1921 AND DRAFTS MUST BE DRAWN ON OR BEFORE May 1st, 1921 AND EACH AND EVERY DRAFT UNDER THIS CREDIT MUST BEAR UPON ITS FACE THE CLAUSE DRAWN UNDER CREDIT No 000 DATED November 1st, 1920 OF THE FIRST NATIONAL CORPORATION BOSTON U S A ADVICE OF EACH AND EVERY DRAFT MUST BE DULY SENT TO The First Naticnal Corporaticn, Boston, Boston, U S.A.
AND A COPY THEREOF TO The First National Corporation, Boston, U.S.A.

THE AMOUNT OF EACH AND EVERY DRAFT NEGOTIATED AND DATE OF NEGOTIATION MUST BE ENDORSED HEREON

WE HEREBY AGREE WITH THE DRAWERS ENDORSERS AND BONA FIDE HOLDERS OF BILLS DRAWN AND NEGOTIATED IN COMPLIANCE WITH THE TERMS OF THIS CREDIT THAT SAID BILLS WILL BE DULY HONORED ON PRESENTATION AT
The First National Corporation
Boston, U.S.A.

YOURS VERY TRULY
THE FIRST NATIONAL CORPORATION

Signature VICE PRESIDENT   Signature TREASURER

FORM 62 —Letter of credit

The taker of the credit may be the buyer or the seller of goods. The credit should not be extended for a longer period than is reasonably necessary, and the

drafts under it should not be drawn for a longer time than is required to cover the shipment, because acceptances must not be used to furnish working capital for the general uses of the business. Their employment should, therefore, be confined to the financing of specific shipments, which will, with reasonable certainty, provide the means of liquidation at maturity.

Storage.—Under certain conditions acceptances may be made to finance the carrying of readily marketable staples in storage. A draft drawn for such a purpose must be secured at all times by a warehouse receipt, except as noted below.

A "readily marketable staple" has been defined by the Federal Reserve Board as "an article of commerce, agriculture or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of prices as to make: (*a*) The price easily and definitely ascertainable and (*b*) the staple itself easy to realize upon by sale at any time."

No enumeration of specific commodities has been made under this definition, but such articles as grain, cotton, wool, silk, metals, coal, oil, hides, leather, building materials, canned foods, sugar, coffee, tea, tobacco and other non-perishable staples stored in independent public warehouses are generally regarded as proper bases for acceptance credits. On the other hand, the Board has ruled, for example, that potatoes, automobiles and automobile tires are not readily marketable staples within the meaning of the Act. Warehouse receipts covering goods made the subject of acceptance transactions must give the bank holding them exclusive control of the goods covered during the life of the credit. It is not sufficient that the receipt be issued merely by a licensed warehouse company. To comply with the regulations of the Federal Reserve Board

the company must be entirely independent of the borrower.

Warehouse acceptances should never be granted for the carrying of goods for speculative account, or where other than a reasonably immediate sale, shipment or manufacture is contemplated, for the reason that the self-liquidating quality which should be inherent in every acceptance would thereby be impaired. It is permissible, however, for the beneficiary to withdraw collateral against a trust receipt where goods have been sold or are to be shipped or manufactured, provided he agrees within a specified time to liquidate the credit or to substitute other suitable collateral of equal value. Warehouse receipts may also be withdrawn temporarily against trust receipt when it becomes necessary, for instance, to transfer goods from one warehouse to another, in which case there should be a definite agreement that new receipts will be substituted immediately after the transfer has been made

Dollar Exchange.—Where payments are to be made in United States dollars by a foreign debtor, it may happen that dollar exchange is not obtainable to cover them. In such cases a foreign bank which has arranged for the privilege may draw on an American bank for the purpose of creating the necessary exchange. The draft is accepted, sold in this market, and the proceeds are credited to the account of the foreign bank, thus furnishing a dollar balance here available to the latter.

Member banks are limited to 50 per cent of their capital and surplus in the acceptance of dollar exchange drafts, and must obtain permission of the Federal Reserve Board to make such acceptances. These must, furthermore, be confined to transactions in countries where the Board has determined that the usages of trade require the drawing of dollar exchange bills

Profit in Making Acceptances.[1]—Three typical acceptance transactions are shown below. The first covers a ninety day bill for $10,000 bought at 6 per cent discount and held to maturity The others show resale after sixty days:

$10,000 at 6 per cent discount, 90 days	$9,850.00
Proceeds (face value) at maturity .	10,000.00
Net return, 90 days	$ 150.00
Rate per annum on $9,850 00, per cent	6.09

It may happen that funds invested for ninety days are unexpectedly needed at an earlier date. When a part of the original term of the bill has run off a resale may, and frequently does, result in a profit, or, in other words, a higher rate of return than anticipated. An illustration of this principle would appear in the purchase of a ninety day bill at 6 per cent discount and its resale after sixty days at 5¾ per cent·

$10,000 at 6 per cent discount, 90 days	$9,850.00
Proceeds of sale at 5¾ per cent for 30 days	9,952.08
Net return, 60 days . .	$ 102.08
Rate per annum on $9,850, per cent	6.22

On the other hand, a buyer of acceptances will naturally want to know how he will fare if rates fluctuate against him. Ordinarily "losses" on this account are negligible, the holder realizing his full principal with a slightly lower rate of income than originally contemplated. To illustrate, suppose that a $10,000 ninety day acceptance is bought at 6 per cent discount and the funds are wanted after sixty days have elapsed. In the meantime rates have advanced to such an extent

[1] From pamphlet by the First National Corporation, Boston

that the bill cannot be sold at better than 6¼ per cent discount for the thirty days remaining to its maturity. In the light of experience in the American market, such a rise in rates, considering the shortening tenor of the bill, would be most unusual However, it will serve to show the results obtainable in an unfavorable case.

$10,000 at 6 per cent discount, ninety days	$9,850 00
Proceeds of sale at 6¼ per cent for thirty days	9,947.92
Net return, sixty days .	$ 97.92
Rate per annum on $9,850, per cent	5.96

The establishment of a discount market in this country is a recent development of our banking system, but its growth has been rapid. In the beginning, banks made acceptances, discounted them for their customers and sold them to other accepting banks, taking their bills in exchange. With a large portfolio of varied names they were in a position to secure immediate accommodation by rediscount or sale at local Federal reserve banks. However, with the great increase in the volume of acceptances executed following our entry into the World War, it became apparent that a wider distribution of bills would be of benefit to the commercial and banking situations. Having this end in view several corporations undertook to supply banks, corporations, and individuals desiring the temporary investment of funds, and their efforts met with a ready response. The market has constantly broadened in scope and will continue to grow as the investment merits of acceptances become generally appreciated.

CHAPTER XXV

THE OPERATION OF A SAFE DEPOSIT DEPARTMENT[1]

Contract.—There should be a contract between the customer and the Safe Deposit Department stating the extent of the bank's liability to the customer. These contracts should be made in duplicate, one to be delivered to the renter for which a receipt should be taken, and one to be retained by the bank.

The numbering of the contract is for the purpose of audit, affording a ready check on clerk in charge of department as to the boxes rented, monies received, etc.

Identification.—An identification system should be maintained for the mutual protection of both the customer and the bank. The signature of customer (or in the case of illiterates, the finger prints) should be on file, together with other descriptive information to aid in identification.

The form illustrated provides for the signature, residence, pass-word and description of renter; also where required, a like record of co-renter.

Acknowledgment of Receipt of Keys.—On reverse side of card is renter's signed agreement to terms of rental, receipt of keys and an acknowledgment of receipt for rental paid.

Release.—When box is surrendered by customer a release should be taken by bank acknowledging receipt

[1] Prepared by the Yawman and Erbe Co, Rochester, N Y, with full acknowledgment as to text and forms W. H K

of contents of box and releasing bank of all liabilities. This release is on the reverse side of card.

Deputy Authorization.—When the renter or renters wish to authorize someone to have access to box, the

RULES AND REGULATIONS SAFE DEPOSIT DEPARTMENT

(REFERRED TO, AND FORMING PART OF THE RENTAL AGREEMENT)

1 The liability of the Bank is expressly limited to the exercise of ordinary diligence to prevent the opening of the within mentioned safe during the within mentioned term, or any extension or renewal thereof, by any person other than the renter or his duly authorized representative, and such opening shall not be inferable from the loss of any of its contents, nor shall the Bank be liable for permitting a deputy of the renter to have access to and remove the contents of said safe, after the renter's death or disability, and before the Bank has knowledge of such death or disability

2 No person other than the renter or his deputy, legally appointed and properly authorized upon the records of the Bank or in such other manner as the Bank may from time to time direct, shall have access to said safe, except the legal representative of the renter after his death or disability, and then subject to the conditions and requirements of the inheritance tax law of the State of Illinois and except as hereinafter expressly stipulated

3 Any one of two or more joint renters shall have access to said safe and may remove the contents thereof, except that if by any action of or against one of said renters or against the Bank, the Bank is forbidden to allow the safe to be opened, it may be closed to all until such action is properly set aside In the event of the death of one of such joint renters the survivor or survivors shall have access to said safe and may remove contents thereof, subject, however, to the provisions and requirements of the in eritance tax law of the State of Illinois, but deputies can only be appointed and authorized by joint act of all such renters

4 No renter, deputy or representative of a renter will be permitted to enter the Bank's vaults except in the presence of a vault clerk or custodian, and then only during business hours, and no renter will be permitted to examine his box or papers in the vaults, but must use the places provided for that purpose

5 The Bank has retained and will retain, no keys that open the said safe, and its contents are and will remain unknown to said Bank unless it shall open said safe and remove said contents as hereinafter authorized

6 The renter shall pay all costs and expenses incident to a loss of the keys or combination to said safe, including the expense of opening and repairing it, and of replacing keys or combination, and on surrender of said safe shall at once turn over to the Bank, all his keys thereto or the combination thereof

7 The Bank reserves the right to terminate the use of said safe by the renter at any time upon written notice mailed to the renter at his address as registered upon its records, or otherwise delivered to him or his deputy or legal representative In such case the Bank shall refund to the renter on demand, proportionate rent for the unexpired term and the renter shall at once withdraw his property and surrender said safe

8 All rentals are payable in advance and the Bank is authorized at the end of fifteen (15) days from the expiration or earlier termination of the within mentioned term, upon written notice mailed to the renter at his address as registered upon its records, to open said safe and remove the contents thereof, which shall then be held by the Bank under the liability of an ordinary storage warehouseman only, and subject to a lien for the payment of storage charges, of any rent unpaid, of a charge for the occupation of said safe after the termination of said term and of the cost and expenses of opening and repairing said safe and replacing the keys or combination thereof The Bank may at its option store said contents in an ordinary storage warehouse for the account of the renter

9 The Bank reserves the right to close said vaults upon any national, state or city holiday, or upon any other day when on account of mobs, unusual crowds, closing of the Chicago Clearing House Association, or for any other reason, the officers shall deem such closing prudent or proper

FORM 63

authority should be in writing and over the signature of renter or renters.

	Safe No.
Signature	Date
Residence	Password
Business Address	
Mother's Maiden Name Birthplace	Age
Height Complexion Hair Eyes Weight	Figure
Signature	Date
Residence	Password
Business Address	
Mother's Maiden Name Birthplace	Age
Height Complexion Hair Eyes Weight	Figure
Deputy	
ROOSEVELT STATE BANK, CHICAGO, ILL.	RENTER

FORM 64 —Safe deposit department entry card

July

Name ______________________ Safe No. ________

Address ______________________ Rental $ ________

Date ________ Time ______________________

Age ________ Height ________ Eyes ________

Hair ________ Face ________ Figure ________

Received from THE SAVINGS DEPOSIT BANK AND TRUST CO ELYRIA OHIO Date ________

A receipt for rental paid for Safe Deposit Box No ________ which is leased by the undersigned subject to all rules and regulations of said bank as embodied in said receip and to all of which rules and regulations the undersigned hereby expressly agrees ____ also acknowledge having received ____ keys of said Safe Deposit Box

____

Witness ________________ ________________________

Date ________

____ hereby authorize ______________________ to have access at all times to Safe No ________ until revoked by the undersigned

Signature of Lessee or Lessees ______________________

Signature of Person or Persons authorized to have access to safe. ______________________

Date ________

The above appointment of ______________________ as Deputy is hereby revoked and withdrawn ______________________

T & E FORM 2708 ★3⁰0

FORM 65.—Receipt of customer for keys—appointment of deputy

Identification.—Identification of deputy or person authorized to have access to box should be as complete as that of renter in order to guard against loss. Description and signature of deputy are on the face of deputy card, appointment or authorization on reverse, and below the revocation of appointment of deputy.

2064 *320 Name	Safe No
Dept for	Date
Signature	
Residence Password	
Business Address	
Mother's maiden name Birthplace Age	
Height Ft. In. Complexion Hair Eyes Weight Figure	
Remarks	
ROOSEVELT STATE BANK, CHICAGO, ILL DEPUTY	

Form 66 —Safe deposit department—deputy card.

Ledger.—A Ledger record is necessary not only for the purpose of keeping an account with renter, but also for systematic follow-up of collection of rentals.

The ledger form illustrated is tabbed January to December. As a box is rented, a card is used bearing the tab with month corresponding to expiration of rental period.

In watching collections and sending out notices, the tabs are of great value. The reversible feature of the card can be used in the following manner. As notices are sent out, the cards can be reversed in the file in which position a red tab will act as a signal of rental due and notice sent. When rent is paid, card is again

APR.

RATE

SAFE NO

RENTER

ADDRESS

RENTER

ADDRESS

RENTER

ADDRESS

DATE PAID	AMOUNT		PAID TO	REMARKS	DATE PAID	AMOUNT		PAID TO	REMARKS

ROOSEVELT STATE BANK CHICAGO, ILL

FORM 67.—Safe deposit ledger card

5

SAFE NO

RENTAL PER ANNUM

RENTED			NAME OF RENTER	LOCK CHANGED			SURRENDERED			REMARKS
MONTH	DAY	YEAR		MONTH	DAY	YEAR	MONTH	DAY	YEAR	

MERCHANTS' AND SAVINGS BANK, JANESVILLE WIS

SAFE RECORD

FORM 68.—Safe deposit department—history of safe deposit box, showing various renters

reversed in file, white tab again showing. The following month all cards with red tab showing in position of previous month are delinquents.

Box Record.—A record of each box should be kept, being a complete history record of succession of renters, key numbers, dates rented and surrendered, changes of locks, etc.

ENTRANCE TICKET

THE UNDERSIGNED DESIRES ADMISSION TO BOX NO ________ IN THE

VAULTS OF ROOSEVELT STATE BANK, CHICAGO
(SAFE DEPOSIT DEPT)

DATE________

SIGN HERE

TIME ENTERED	TIME DEPARTED
	APPROVED
	CUSTODIAN

Form 69.—Safe deposit department entrance ticket.

These cards are filed by box number, and when a card is reversed in its place in the file, the red tab will indicate the box is not rented. This feature is sometimes used to indicate boxes that are for rent, or if another system such as we later describe is used, the red tab acts as a check on the other system. (See "Key Control," p. 793.)

Entrance Ticket.—An entrance ticket should be signed by each renter or his deputy when he applies for admission to his box. This signature should be compared with signature on identification card.

If the signature agrees, the attendant then stamps the time in space "Time Entered." After box is opened,

(the box should only be opened in presence of attendant and renter) renter's key should be removed from lock and box taken to private room. (Keys should never be left sticking in lock.)

When renter returns box to safe, entrance ticket should be stamped showing time departed.

5

BOX | NAME | YEAR

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
JAN																															
FEB																															
MAR																															
APR																															
MAY																															
JUNE																															
JULY																															
AUG																															
SEPT																															
OCT																															
NOV																															
DEC																															

LIBERTY BANK OF BUFFALO, MAIN OFFICE

FORM 70.—Safe deposit department—record of box entries

Call Record.—In order to tell quickly when or how often anyone (renter or deputy) has entered box, the call record card is used. On this card is posted record of calls made by renter or deputy which is obtained from entrance ticket described on preceding page.

Key Control.—All keys to unrented boxes should be safeguarded by being kept under double control so that it will be impossible for any one employee to have access to keys. This will guard against the possibility of a dishonest clerk having additional keys made to boxes that will later be rented. Locks should be changed when boxes are abandoned or exchanged.

To facilitate double control, many vaults are equipped with a special locker to retain these keys. This section is equipped with a false bottom which is slotted to

ROOSEVELT STATE BANK
SAFE DEPOSIT DEPARTMENT No. 2790

Chicago, Ill., ____________ 19___

Received from ____

____ Dollars for the use

of Safe No __________ in the Vaults of this Bank

from ______________________ 19___ to ______________________ 19___
Subject to the Rules and Regulations made by the Bank appertaining thereto (See other side)

____
CASHIER

FORM 71 —Safe deposit rental receipt

hold the keys in an upright position. Keys should be arranged in the same order as boxes, numbers corresponding. A glance at the contents of a drawer will quickly tell which boxes are rented.

APPENDIX

THE TWELVE FEDERAL RESERVE BANKS AND THE BRANCH BANKS OF EACH

BOSTON:
- Havana, Cuba agency

NEW YORK:
- Buffalo branch

CLEVELAND
- Cincinnati branch
- Pittsburgh branch

RICHMOND
- Baltimore branch

ATLANTA:
- New Orleans branch
- Jacksonville branch
- Birmingham branch
- Nashville branch
- Havana, Cuba agency

CHICAGO
- Detroit branch

ST. LOUIS
- Louisville branch
- Memphis branch
- Little Rock branch

MINNEAPOLIS
- Helena branch

KANSAS CITY.
- Omaha branch
- Denver branch
- Oklahoma City branch

DALLAS.
- El Paso branch
- Houston branch

SAN FRANCISCO
- Los Angeles branch
- Portland branch
- Salt Lake City branch
- Seattle branch
- Spokane branch

PHILADELPHIA
- No branches

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